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Politics this week

Mar 18th 2004
From The Economist print edition

After Madrid

Reuters

The Socialists unexpectedly won **Spain's** election, just three days after the train bombings in Madrid. José Luis Rodríguez Zapatero, the new prime minister, swiftly promised to pull Spanish troops out of Iraq, calling the occupation a “fiasco”. The Socialists benefited from an unexpectedly high turnout, and from the anger of many voters over the Aznar government's attempt to attribute the bombings to the Basque terrorist group, ETA.

The blame for the bombings was instead ascribed to **Islamic terrorists**, possibly linked to al-Qaeda, with suspicion falling particularly on several Moroccans. Other European countries, especially Britain and France, were braced to be likely next targets.

See article

Serbs and Albanians clashed in **Kosovo** in the worst outbreak of violence since NATO and the UN took control of the Serbian province in 1999. At least 22 people were killed.

See article

Russia's voters duly re-elected Vladimir Putin as president, giving him over 70% of the vote. But the Communist candidate, Nikolai Kharitonov, did better than expected, winning some 14%.

See article

A threatening stand-off developed in **Georgia**, as the newly elected president, Mikhail Saakashvili, tried to assert control over the breakaway region of Ajaria. The Ajarian leader, Aslan Abashidze, who is backed by Russia, refused him entry, though later the two men did agree to talk.

See article

Stamping on reform

Saudi Arabia's police detained at least ten dissidents, most of them prominent liberals, in an apparent effort to stem a groundswell of reformist activism. The government also suspended 900 imams for “various flaws” in their preaching.

Clashes with police left some 25 dead in parts of **Syria** dominated by the country's 2m-strong ethnic Kurdish minority. The trouble started as a football-match brawl between ethnic Arabs and Kurds, and grew into the country's worst civil unrest in 20 years.

EPA

A car bomb ripped into a hotel in **Baghdad**, killing at least six. The American army said it was probably planted by Islamist militants, perhaps linked to al-Qaeda.

Zimbabwe's government charged some 70 suspected mercenaries with plotting to overthrow the president of Equatorial Guinea. The men were arrested when their plane stopped in Harare, allegedly to buy arms from a

Zimbabwean state-owned firm.

See article

Rwanda's president, Paul Kagame, accused France of “directly” abetting the 1994 genocide. The accusation followed French allegations that Mr Kagame ordered the shooting down of a plane containing the then president, Juvenal Habyarimana, also in 1994. That murder became a pretext for the genocide.

Stop the wedding

California's Supreme Court ordered San Francisco to stop issuing marriage licences to gay couples but did not void licences previously granted. Several couples whose wedding plans were thwarted by the ruling are suing the state.

In **Illinois**, Barack Obama and Jack Ryan won their respective Democratic and Republican primary elections and will contest a Senate seat in November. It is expected to be one of the most competitive races of the year.

The Department of Agriculture expanded its surveillance programme in response to America's first detected case of “**mad cow**” disease last December. Usually, some 20,000 cattle are tested each year; now over 260,000 will be examined over 18 months at a cost of $70m.

John Kerry secured the delegates needed to win the Democratic nomination for president. Meanwhile, Mr Kerry claimed that several world leaders had told him they were backing him to win. The Bush administration challenged him to name them.

Clinging to power

AFP

President Roh Moo-hyun was impeached by **South Korea's** parliament for saying he would do whatever is legally possible to help the party that backs him gain seats in the forthcoming general election. Mr Roh's fate now rests with the constitutional court. Tens of thousands of South Koreans showed their disapproval of the impeachment by taking to the streets.

See article

Pakistan's army launched an offensive against Taliban and al-Qaeda fugitives near the border with Afghanistan, a few days before America's secretary of state, Colin Powell, visited both India and Pakistan. The American-led coalition forces conducted a similar operation on the other side of the border. Mr Powell said that America would designate Pakistan a “non-NATO ally” and would give Afghanistan a further $1 billion in aid.

AFP

India's cricket team continued its first tour of **Pakistan** since 1989, with millions of fans on both sides of the border eagerly following the matches. The tour is one of a series of concessions offered by India last May, which also included the resumption of diplomatic relations and transport links.

See article

Edging back

Jean-Bertrand Aristide, **Haiti's** ousted president, moved closer to home, from exile in the Central African Republic to Jamaica, to the irritation of American officials. Haiti's new prime minister named a cabinet without Aristide supporters—none had applied, he said. In Haiti's slums, Aristide loyalists took sporadic potshots at the multinational force policing the country.

See article

The efforts of **Venezuela's** opposition to stage a recall referendum on President Hugo Chávez got a boost. The electoral chamber of the country's Supreme Court struck down a decision by the electoral authority which had annulled 800,000 signatures on a referendum petition. The government appealed to another branch of the court.

Marta Sahagún de Fox, the wife of **Mexico's** president, Vicente Fox, corrected her husband after he said that she would not be a candidate to succeed him in 2006. “I haven't taken a decision yet,” said Mrs Fox.

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Business this week

Mar 18th 2004
From The Economist print edition

Mutual understanding

Bank of America and **FleetBoston Financial** agreed to pay $675m to resolve separate charges that they were involved in the improper trading of mutual funds. BofA is aiming to complete a $47 billion acquisition of FleetBoston in April. Their merger will reportedly eliminate 13,000 jobs, some 7% of the banks' combined workforce.

See article

BNP Paribas extended its presence in American retail banking with the purchase of Community First Bankshares for $1.2 billion. The French bank said that it was considering other acquisitions in Europe and America.

Bear Stearns reported record profits in the first quarter. The American investment bank said that it made $361m, 32% more than a year ago. **Lehman Brothers** also had a good quarter: profits more than doubled to $670m.

Martha's back-seat role

Shortly after her conviction for lying about a suspicious share deal, **Martha Stewart** resigned from the board of the company that she founded. Martha Stewart Living Omnimedia will continue to benefit from her advice through her new role as “founding editorial director”. It is possible that she will be sent to jail when she is sentenced in June.

A week after **Nortel Networks** revealed that it may have to restate results for 2003 and earlier for a second time, it suspended two top finance executives. The whiff of an accounting scandal sent shares in the Canadian telecoms-equipment firm tumbling.

Enrico Bondi, appointed by Italy's government to rescue **Parmalat**, revealed his plans for saving the dairy company from the financial scandal engulfing it. He proposes swapping *euro*14.8 billion ($18 billion) of debt for shares and selling minor businesses.

Jean-Pierre Raffarin, France's prime minister, backed a hostile bid by **Sanofi-Synthélabo** for **Aventis**, a rival French drug company. Mr Raffarin said that the threat of a biological attack by terrorists made access to vaccines imperative. Business leaders complained that the intervention might deter foreign investment. Novartis, a possible “white knight” bidder for Aventis, denounced the statement.

Microsoft talks fail

The European Union said that talks with **Microsoft** to settle antitrust charges had failed. The 15 member states of the EU earlier backed a draft ruling from the European Commission that would force Microsoft to share proprietary information and unbundle its media software from its Windows operating system. Microsoft is also expected to face fines running to millions of dollars when a final decision is issued on March 24th.

John Malone, boss of **Liberty Media**, announced a spin-off of the American media firm's international operations to shareholders. The idea is to trim the firm's complex structure. Liberty reported a $931m loss in the fourth quarter.

America's **Electronic Data Systems** agreed to sell its design-software business, **UGS PLM Solutions**, to a consortium of three private-equity companies for $2.05 billion. The sale accords with EDS's plan to concentrate on running networks for other companies. The cash will go towards paying off debt.

Bombardier, a Canadian plane- and trainmaker, announced that it would shut seven rail plants in Europe and cut 6,600 jobs around the world. Restructuring costs helped to push Bombardier to a loss of C$448 million ($341m) in the latest quarter.

Cheap as chips

America prepared to make a complaint at the **World Trade Organisation**, alleging that China is subsidising domestic chipmakers through tax breaks. American chipmakers claim that the scheme has cost exports and American jobs. China denies the charges.

Meanwhile, the AFL-CIO, America's trade-union federation, called on George Bush to impose **trade sanctions** against China, claiming that a repressive attitude to workers' rights gives it a competitive edge. Previous efforts have proved unsuccessful but have not come in the run-up to a presidential election in which American jobs are a key issue.

America's **Federal Reserve** held interest rates at 1%, citing concerns over the slow pace of job creation despite a “solid” economy, and noting that inflation had remained low. Many Fed-watchers inferred that rates would rise later rather than sooner.

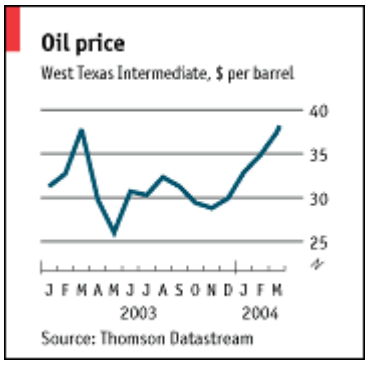
See article

Barrelling along

Royal Dutch/Shell, which has been harshly criticised for misstating oil and gas reserves, announced a further cut in reserves of 250m barrels. The company also said it would delay publication of its annual report and postpone its shareholders' meeting.

Oil prices hit a 13-year high. Fears of terrorist action to disrupt supplies in the aftermath of the Madrid bombs, heavy demand from China, low stocks in America and planned quota cuts by OPEC have combined to push prices to over $38 a barrel.

See article



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After Madrid

One down, three to go?

Mar 18th 2004
From The Economist print edition

Governments come and governments go, but the fight against terrorists must be stronger than ever

AP

IF YOU carry out a well planned atrocity, killing more than 200 people and injuring more than a thousand, and three days later the government that supported an invasion to which you object is unexpectedly defeated in a general election, you are entitled to consider the venture to have been a success. So although Spain's high voting turnout on March 14th, and many Spaniards' apparent ire at the way José María Aznar's government had prematurely blamed Basque terrorists for the outrage, can be taken as healthily democratic signs (see article), there is no escaping the fact that the biggest triumph has been that of the terrorists. Assuming, as is likely, that they are indeed linked to or are members of Osama bin Laden's al-Qaeda network, they scored another success when the new Socialist prime minister, José Luis Rodríguez Zapatero, said he would withdraw Spain's 1,300 troops from Iraq. This may only be a symbolic move, for that is a mere 1% of the American-led coalition's forces there, but symbols and emotions are what terrorism is all about.

To say all that is not to say that it is wrong to vote out governments that supported the invasion of Iraq a year ago. In some cases, such as Spain, they did so against a huge majority of public opinion. In all cases, their claims that Saddam Hussein had stockpiles of dangerous weapons now look to be a blunder, a gamble or a deception. This year both George Bush himself and John Howard, Australia's prime minister, face re-election contests and next year Britain's Tony Blair is also expected to do so. There is now a real possibility that all three could follow Mr Aznar's party into defeat—though Mr Blair may be saved by the fact that his Tory opposition supported the war strongly, too. Such defeats would be natural, in democratic terms. But the tragedy of Madrid is that the terrorists in effect cast the swing vote, given that Mr Aznar's party had looked set to win a comfortable victory, despite opposition to the war, and that such success may now stimulate more terrorism during the other three electoral campaigns. The big question, if such defeats occur, is whether successor governments would be more effective in pursuing al-Qaeda and stabilising the regions within which its terrorists thrive—or less.

One year on

Some critics of the war in Iraq say that there is no such danger. There was no genuine link between toppling Saddam and fighting al-Qaeda, so to punish governments for what opponents claim was an illegal invasion is a quite separate matter. Mr Zapatero even appears to think that pulling troops out of Iraq will make things better, on the view that the occupation is itself the cause of terrorism. Yet that policy is irresponsible, because it increases the risk of civil war in Iraq. Even those who opposed the war should now want to help make Iraq secure enough for Iraqis themselves to take back their sovereignty. If other new governments copy Mr Zapatero and prove their anti-war point by withdrawing from Iraq, they will make everyone less safe as a result. And it is a delusion to claim, as Mr Zapatero does, that all would be well if the UN were to take over from the Americans. Few Iraqis think so. It is as well to recall the Dutch UN peacekeepers who looked on helplessly during the Srebrenica massacre in Bosnia in 1995.

Moreover, withdrawal would put the rest of the Middle East at greater risk, too. For even if there was no direct link between Saddam and al-Qaeda, the connection was always indirect and much more long-term: that while he remained in power to threaten his neighbours and required bombing and sanctions to

contain him, it would be impossible to move towards a wider peace and modernisation of that whole troubled region. To advocates of the war, including *The Economist*, sticking with the status quo looked a more dangerous option than toppling Saddam.

On that view, the stance taken against Saddam by Messrs Bush, Blair, Howard and Aznar could prove to have been politically suicidal but historically noble. But will it, really? One year after the invasion it remains too soon to say. Many things have improved in Iraq since Saddam's regime was removed, but the situation remains fragile and the danger of civil war real (see article). A new opinion poll this week suggested that Iraqis are rather more positive about the change in their lives than outsiders are, but attitudes vary around the country. The invasion itself, and the show of American strength that it entailed, has produced some promising changes in the surrounding region, too, in relations with Libya, Syria, Iran and Pakistan, and glimmerings of democratic reform in Saudi Arabia. Those moves have so far been modest, however, and this week the Saudi authorities underlined that fact by arresting some prominent reformists. Moreover, such modest gains have been overshadowed by the complete lack of progress in pacifying the region's most bitter conflict: that between Israel and the Palestinians.

The right grounds on which to criticise and even condemn the perpetrators of regime change in Iraq now lie in that slow or non-existent regional progress. They, especially the Bush administration, do deserve criticism for their mishandling of the post-war situation in Iraq, but the correct response is to strengthen the effort to rebuild and secure Iraq, not weaken it. They deserve much more criticism, though, for having so far failed to turn the strategic change represented by the fall of Saddam into a wider and more profound set of changes: notably, a restoration of full relations with Iran and the establishment of some sort of Arab-American alliance to persuade the Israelis and Palestinians back to the negotiating table. Such things could never have happened overnight and many a previous attempt, whether American or European, has foundered amid the blood of the Middle East. Yet as the terror in Madrid showed, time is on no one's side. In contrast to its urgency over invading Iraq, the Bush administration has shown little urgency in trying to achieve these wider goals.

Would new governments, led by John Kerry, Mark Latham (in Australia) and Michael Howard (in Britain), do better? It is premature, in all three countries, to judge. No doubt, all would find the reality of government tougher than the theory of opposition. What is clear, though, is that the challenge is the same whether these countries elect new leaders or stick with the old ones: it is to combine the immediate task of detecting and punishing terrorism with the broader, longer-term tasks of blocking weapons proliferation and persuading the Muslim world to modernise. That will require a greater effort to capture al-Qaeda's fugitive leaders in Afghanistan and Pakistan, involving even more pressure on Pakistan's government to catch those terrorists and at the same time to prevent its own nuclear secrets from being sold to them or to other countries. It will require some new version of the tentative “Greater Middle East Initiative” for democratic reform just floated and then withdrawn by the Bush administration. And it will require a big new push on Israel and Palestine.

It is fashionable to argue that all this will require greater co-operation, on a multilateral basis, than the Bush administration has managed to achieve during the past three years, and more emphasis on the “soft” power of persuasion and influence. That is true, but it will also require military toughness, redoubled intelligence efforts and intensified security. This is no time for weakness or appeasement. That is the ultimate lesson from Madrid.

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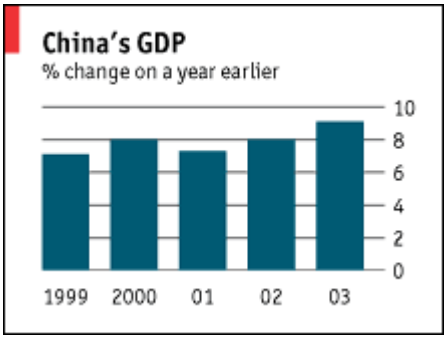
China's economy

Losing its balance

Mar 18th 2004
From The Economist print edition

China needs to slow its economy. But can it do so without crashing it?

THE effect is both magnetic and awe-inspiring. From the outside China's progress looks brilliant. The country's breakneck growth—on average 9% a year since reforms began in 1978—has been the envy of the world and a boon to global markets. In the past 25 years still-communist China has been the fastest-growing large economy in the world. At $1.4 trillion, it is already the globe's sixth-largest in terms of gross domestic product. Foreign firms have responded with enthusiasm, investing heavily in the country (see our survey).



A two-speed economy

But can China continue to expand at this pace? Almost certainly not, at least at its recent even-more-rapid clip. Much of China's growth is the welcome product of economic reforms. But too much of recent growth has also been the result of an investment boom fuelled by easy credit. The result is a bifurcated economy. On the one hand, demand in such sectors as property, cement, steel and cars has grown so fast that it is alarming even the leadership in Beijing. At the country's annual National People's Congress that concluded on March 14th, the prime minister, Wen Jiabao, warned that the bank lending which is fuelling such demand must be curbed if China is to maintain its economic stability. On the other hand, the rapid expansion in production capacity, especially by Chinese firms supplying the domestic market, has resulted in an accumulating surplus of other manufactured goods.

This over-investment is currently one of China's biggest problems, pointing to future deflation. Worse still, China's recent growth has become increasingly inefficient. Its ICOR (incremental capital-output ratio), which measures how much growth “bang” China is getting for its investment “buck”, indicates that the country is having to plough in more money to generate the same growth—currently more than $4 to generate each additional $1 of annual output compared with $2-3 in the 1980s and 1990s. This is unsustainable. In 2003 an unparalleled 47% of China's GDP was accounted for by fixed capital investment. China's economy must slow down.

There are early signs that this may be happening. Apparently well aware of the problem, China's policymakers have started to tighten credit. Figures for the first few months of 2004 show that car sales, retail sales, food prices and inflation appear to be moderating slightly. But the problem for a country that has still travelled only a part of the way from socialism to capitalism is that the normal mechanisms that regulate a genuine market economy do not work properly. China's leaders have only the bluntest tools at their disposal and limited room for manoeuvre. A rise in interest rates would help to curb credit even further, but that could cripple the government's finances at a time when the country is already running a large budget deficit—its public debt, now 30% of GDP, is rising rapidly. Instead, policymakers are resorting to very communist solutions—ordering their banks to stop lending to over-frothy sectors. That only reinforces the banks' unhealthy ties to the government and hampers their ability to make independent commercial decisions on lending.

A revaluation upwards of the yuan-dollar peg could slow over-rapid growth and would be warmly welcomed by the rest of the world. But that might also be a blow to the country's successful exporters—many of which happen to be foreign-invested companies. This is one reason why the government, despite prodding from America, continues to set its face against an appreciation of its currency.

There is a real possibility, therefore, that any concerted and consistent attempt by China's leaders to

slow their country's economy may fail to achieve a soft landing and instead bring on a crash. Again, Mr Wen and his colleagues are well aware of the conundrum. They have to maintain a precarious balance. While the current pace of growth cannot last, equally China cannot let its economy slow too much. Its leaders need at least 7% annual growth, they reckon, to continue to create enough jobs to absorb surplus rural labour and the workers laid off by state-owned enterprises. And, to avoid creating social instability, they need to revitalise a countryside that has been left behind in what has been a primarily urban boom.

The capitalist road

So what should China's leaders do? There is no single remedy for the range of dilemmas facing them, and no simple way to slow growth safely. Instead, they have to consider a range of risky, but necessary measures. In the short term, they are right that a full flotation of the Chinese currency is too fraught with danger, but raising its value gradually against the dollar should be possible. This could restrain growth in the domestic money supply, curbing demand, without being too big a blow to exporters. At the same time, they must move more aggressively to liberalise China's financial sector in order to introduce real price signals—freeing banks to set interest rates on loans and to make their own decisions; inviting foreign investment into the banking industry; and encouraging new non-bank financial rivals.

Just as urgent is the need to push ahead with structural changes which may have an effect only in the longer term, but are crucial if China is to maintain growth and avoid a crash. Genuine privatisations of state-owned enterprises are essential, even if that results in many of them shedding workers. Private businesses could supply new jobs to replace the ones lost in the state sector if they are given the freedom to grow. That means streamlining China's huge bureaucracy, which tangles too many firms in red tape and corruption. Gradually reducing corporate and personal tax rates, among the highest in Asia, would also help firms to grow.

Finally, China's leaders must, sooner rather than later, embrace land reform, awarding 800m rural dwellers the right to secure ownership of the land which they farm. This could give millions of Chinese the incentive to invest in improving their farms, turning them into small businessmen and consumers. None of these measures will be easy. But all are necessary if China's dazzling success is not, some day, to turn to dust.

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The British budget

Lucky Gordon

Mar 18th 2004
From The Economist print edition

The chancellor deserved his luck on the economy. On the public finances, he is pushing it

Reuters

Get article background

GORDON BROWN, who delivered his eighth budget this week, will soon achieve a remarkable record in political longevity. Already, he is the longest serving post-war chancellor of the exchequer, having wrested this accolade from Nigel Lawson, the Tory finance minister in 1983-89. This summer, he will surpass David Lloyd George, who held the post in the early 20th century, to become the longest serving chancellor in the past 100 years. Lloyd George laid the foundations of the welfare state with his redistributive “people's budget” in 1909. Mr Lawson cut punitive income-tax rates but is now best remembered for the boom that turned into slump in the early 1990s. What will history make of Mr Brown?

If the judgment were only about “the economy, stupid”, things are, so far, looking good. Mr Brown has delivered the end to boom and bust that he promised. Unlike most other big economies, Britain has withstood the world recession and has grown steadily over the past few years. Inflation has remained tame even though unemployment has steadily declined.

Mr Brown cannot take all the credit. He was in the right place at the right time. His predecessor, Kenneth Clarke, engineered a smooth recovery from the Lawson bust. The inflation-targeting regime, introduced after Britain was spat out of the European exchange-rate mechanism in 1992, was already proving a success. The outstanding economic achievement of the past few years has been the improved performance of the labour market, for which the Tories were largely responsible.

Mr Brown's initial contribution was to reinforce the inflation-targeting regime by handing over interest rates to the Bank of England. That bold decision has underpinned the credibility of the government's management of the economy. A related achievement, reaffirmed in his budget speech, has been to keep Britain out of the euro. Whatever the political merits of joining the single currency, the economic price would have been too high. As the Treasury showed last year when re-assessing the case for membership, the economy would have been a lot more unstable inside the euro area.

But if Mr Brown has helped to banish boom and bust in the economy, he has presided over bust and boom in the public finances. Early in his chancellorship, he made much of his prudence. He sat on spending and put up taxes, notoriously through his £5 billion ($9 billion) “stealth” raid on pension funds. And once again, the chancellor was lucky. The dotcom frenzy and stockmarket boom generated a surge in taxes paid by high earners and City firms.

Mr Brown's good fortune tempted him to push his luck. Four years ago, the chancellor sanctioned an extended spending spree on the public services. Although Mr Brown put up taxes in his post-election budget in 2002, his determination to pump money into public services, especially the National Health Service, has driven the public finances deep into the red. A £15 billion surplus in the fiscal year 2000-01 has turned into a £38 billion deficit—3.4% of GDP—in 2003-04.

Are you getting your money's worth?

In this week's budget, Mr Brown announced that the six-year public-spending boom would come to an end after 2005-06, with the exception of the NHS and education. But even though the chancellor is reining in expenditure, a structural deficit of at least £10 billion is likely to remain as tax revenues fail to return to their previous peak. Taxes will therefore have to go up again, though not until after next year's election.

If the extra money had been well spent, Mr Brown could be forgiven for abandoning prudence. But the cash is flowing too fast to be well spent, and the government has been too timid in making structural reforms to public services. Rather than allow choice and competition to drive improvements, the chancellor has relied on top-down targets to ensure that extra money leads to better performance. These have made matters worse by generating a blizzard of paperwork and alienating staff. Earlier this month, the IMF expressed worries about the boom in spending on public services; and polls suggest voters are not convinced that they are getting their money's worth.

The most important thing any chancellor can do is to avoid messing up the economy, and, in the short term, good macroeconomics gives the government a strong political hand. In the long term, though, excessive public spending, higher taxes and more regulation will hurt growth. Mr Brown has been lucky, but luck is not enough.

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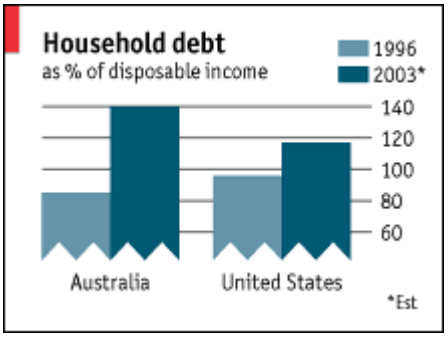
The Australian economy

America's ugly sister

Mar 18th 2004
From The Economist print edition

Australia's economy looks suspiciously like America's just before its bubble burst

Get article background



IN LATE 1995, when Australia had a huge current-account deficit of 5% of GDP, *The Economist* suggested, tongue in cheek, that Australia looked rather like Mexico before its currency collapsed at the end of 1994. We predicted that the Australian dollar would also tumble. The Aussie dollar did indeed fall by over 40% over the next five years. Today we feel compelled to make another rude observation: the Australian economy now looks not like Mexico's, but like that of its bigger neighbour, the United States—just before its bubble burst in 2000.

In the same way as America enjoyed a "new economy" in the 1990s, so too has Australia's economy seen dramatic improvements. Thanks to wide-ranging structural reforms and sounder monetary and fiscal policies, Australia's economy has recently been one of the best performers in the world. It has enjoyed 12 years of uninterrupted expansion, with annual growth averaging almost 4%. Australia's productivity growth has nearly doubled over the past decade, outpacing even America's. Thus Australia is sometimes described as a Cinderella economy, transformed from a poor scullery maid to a glittering princess. Look closer, however, and the Australian economy is not Cinderella, but America's ugly sister.

Australia's productivity gains, like America's in the 1990s, have been genuine. But after any long economic boom there is always the danger that people get carried away, believing erroneously that the economic cycle has been banished. Having narrowed in the late 1990s, Australia's current-account deficit has swollen again to 6% of GDP, even bigger than America's. As consumer spending has outpaced incomes, household saving has plunged. Australia now has a negative saving rate. Households have been on an extraordinary borrowing binge, with debt rising more than twice as fast as in the United States over the past decade. Much of this borrowing has been done to buy homes, not just to live in, but as an investment. Residential property prices have soared. Some 45% of all new mortgage borrowing last year was by investors chasing capital gains, not owner-occupiers. Australia has become another hotbed of irrational exuberance.

One big difference between Australia and America is that, while Alan Greenspan, the chairman of the Federal Reserve, can be criticised for cheering on the bubble through his over-enthusiasm for the new economy, the Reserve Bank of Australia has given repeated warnings about soaring household debt and house prices in an effort to cool things down. The Reserve Bank raised interest rates twice last year partly because of such concerns. Arguably it could have done more. But if anything is to blame for Australia's housing bubble, it is not the central bank, but the government's tax policies. Since 1999 the tax rate on capital gains has, in effect, been half the top rate of income tax, luring more speculative money into property.

The housing market now seems to be wobbling (see article) and there is a risk that property prices could fall sharply. When housing bubbles burst they harm economies much more than stockmarket bubbles, because people have a lot more money tied up in houses than in shares, and the associated credit boom makes consumers vulnerable. The good news is that there is plenty of room for Australia to cut interest rates and taxes if necessary to support the economy. The government has a budget surplus and its debt of 18% of GDP is the lowest of any big rich economy. But the clock is striking midnight on Australia's boom: a downturn may not be far off.

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Board directors

No more Mr Nice Guy

Mar 18th 2004
From The Economist print edition

Independent directors at big public companies need to be tougher

WHERE were they? The rash of corporate scandals over the past few years has produced not only outrage at the greed and shenanigans of top executives, but also incredulity that their boards of directors went along with their misdeeds. What did directors know and when did they know it? Were they, too, corrupt, or merely incompetent or complacent? These are now the questions being asked in dozens of criminal investigations and scores of lawsuits. At the same time, regulators in America and Europe have placed new burdens on board directors and, despite the perceived failure of so many directors in the recent past, the favourite remedy for ensuring corporate rectitude in the future is to appoint a new generation of directors who will, next time, be truly independent and ever watchful. What was once often a comfortable, and lucrative, sinecure is beginning to look like the job from hell.

As a result, the behaviour of corporate boards has already begun to change in important ways (see article). But there is still much confusion. What exactly are directors supposed to be doing? The answer seems obvious: representing shareholders. Yet what is the best way to do that? Should directors aim to help the chief executive—who, after all, is also supposed to be acting in the best interests of shareholders—by offering advice on management or strategy? Or is the main task of independent directors to monitor a firm's managers, and make sure they obey the rules, don't pay themselves too much and generally behave? In other words, should directors see their role as that of colleague or cop?

“Both”, would be the ideal answer. And in superbly run firms, playing both roles simultaneously may be possible. But in many big companies, directors have found it impossible to be both effective guard dogs and loyal members of the pack, and most have chosen to be the latter. This has also been the choice that most bosses want them to make. How much more comfortable it is to work chummily with the clever person who has appointed you, or had a strong say in your selection, than to look continuously over his shoulder and ask awkward or embarrassing questions. It is understandable that so many directors have taken this approach, but it is the wrong one.

The perils of collegiality

The primary function of independent board directors in a large public company is to monitor the firm's managers, not to give strategic or managerial advice, and directors should allow nothing to impair their monitoring role. Most big firms operate in highly competitive markets, and honest strategic errors will be quickly punished by rivals. Moreover, bosses are not short of advice, from consultants, industry experts and management gurus, not to mention their own subordinates. But market competition cannot monitor the internal workings of a firm, check an overweening boss, expose a fraud or simply stop top managers from paying themselves far too much. Only independent directors can perform these essential tasks.

This inevitably will require more of an adversarial stance from directors. Of course, to act as effective monitors directors need to know enough about a company's operations to ask the right questions, and they will form views on its strategy. If they think a firm is headed in the wrong direction, they should say so. But they must remember that their first duty is to speak for shareholders, and that the firm's boss works for them, as the shareholders' representatives, not the other way around. Despite encouraging steps in this direction, there is a long way to go. Warren Buffett, the world's most successful investor and an acute observer of corporate America, has no doubt about this. For him the “acid test” of directorial

independence is chief executives' pay, which has continued to soar, at least in America, through good times and bad. And he has no doubt about why this “piracy”, as he calls it, has succeeded. Too often, he has written, “boardroom atmosphere” means that collegiality trumps independence. Whenever it does, millions of shareholders are the losers.

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Colombia

Too much of a good thing

Mar 18th 2004
From The Economist print edition

Álvaro Uribe and the dangers of elected autocracy

AP

SELDOM has there been such a divorce between the way a political leader is viewed by outsiders and how he is seen by his own people. Abroad, Álvaro Uribe, Colombia's president since August 2002, is viewed by many as a fascistic ogre in league with right-wing paramilitaries to trample human rights. Most Colombians, by contrast, reckon their president has improved their human rights, by starting to tame three irregular armies with tough security policies. Polls show some 80% of respondents approve of Mr Uribe.

That has prompted his supporters to propose an amendment to Colombia's constitution to allow a sitting president to seek a second, consecutive, term. A sensible move, many might say. Four years are too few to deal with Colombia's formidable problems. Having found a president of whom they approve (the previous two disappointed), surely Colombians should have the chance to keep him there for a bit longer?

That argument is tempting, but flawed—though not for the reasons advanced from afar. On human rights, on balance, Mr Uribe is vindicated. He contends that the democratic state must impose its authority on the far-flung reaches of a country twice the size of France and of impossible geography. To do this, he has pursued the left-wing FARC guerrillas energetically, sent police to 158 municipalities that lacked them, and created part-time “peasant soldiers” to improve rural security. The result: murders and kidnaps have fallen sharply.

The record is not without blemish. Mr Uribe's peace talks with the paramilitaries have looked like an effort to pardon their leaders, who include mass murderers and drug traffickers. Killings of trade-unionists and of human-rights activists by paramilitaries remain shamefully common—if less so than they were. Yet he is not to blame, as some claim, for the appalling plight of Ingrid Betancourt, a Colombian politician who was kidnapped by the FARC two years ago (see article). Rightly, Mr Uribe sees a “humanitarian exchange” (the Orwellian term of its promoters) of Ms Betancourt and other hostages for guerrilla prisoners as a recipe for more kidnappings.

Checking over-mighty executives

Yet Colombia would still be rash to allow Mr Uribe's re-election as long as its democracy remains unconsolidated. Faced with exceptional violence, Mr Uribe has reached for some exceptional measures. An anti-terrorism law gives the armed forces sweeping judicial powers of arrest and interrogation. Another bill would give the president power to choose the attorney-general (currently picked by Congress) and restrict the powers of the courts to challenge the executive.

Some of these measures are justified, but others are not. The weakening of checks and balances would be even more worrying if combined with a two-term presidency. Mr Uribe would have the potential, should he wish, to turn himself into an elected autocrat, along the lines of Hugo Chávez next door in Venezuela or, in the 1990s, Alberto Fujimori in Peru.

Colombia's legalism has long sat awkwardly with its lawlessness. But its traditional suspicion of over-mighty executives has also been a hidden strength in a region where *caudillos* thrive. In 1991, Colombia loosened its ban on re-election: a president can seek a second term but not consecutively. That remains a wise balance. Many of Mr Uribe's policies deserve to be continued (and improved upon) by a successor.

Better four years of success than eight or more that end in tears.

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Letters

Mar 18th 2004
From The Economist print edition

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In old California

SIR – Does Samuel Huntington not see the irony in criticising the Mexican presence in Los Angeles, San Antonio, Santa Fe, San Diego, San Francisco, Las Vegas, anywhere in California (originally Alta California) or even New Mexico (Lexington, March 6th)? Anglo dominance in southern California began only around the turn of the last century and according to Mr Huntington ended round about the turn of this one. This represents less than half of a 250-year history. “Two peoples, two cultures, two languages” created California which, in spite of our problems, is still the “Golden State”.

Leeaundra Temescu
Los Angeles

Mother knows best

SIR – You miss the single most important reason why long-surviving matriarchs tend to have more grandchildren (“Grandmother's footsteps”, March 13th). Any childless, married adult with a living mother or mother-in-law knows of the constant and subtle (and sometimes not so subtle) pressure these women put on their offspring to create the next generation. With increased proximity and frequency of contact, the more frequently is the unsolicited “advice” given.

Richard Teply
Prague

Well schooled

SIR – Thank you for opening my eyes further to the conservative movements here in America (“Dreaming of spires”, February 28th). I shudder to think about brainwashed fellow young adults at Patrick Henry College. I am glad that I am safely ensconced in my bubble of San Francisco enjoying an atheist life complete with a holy trinity of sex (gay and straight), drugs and rock 'n' roll.

Tanuja Goulet
San Francisco

Slim chance

SIR – Your position is that governments should not act to influence personal dietary choices (“Fat of the land”, March 6th). If that is so for the demand side, should it not also apply to the supply side? Governments on both sides of the Atlantic grant vast subsidies to agriculture, leading to the overproduction of grain, livestock, sweeteners and vegetable oil. These materials are converted into mass-consumption processed foods that are marketed to the working classes and contribute to obesity. The subsidies should cease. Subsidising exercise and education seems much wiser.

Edward Ho
San Francisco

SIR – While most people assume that snake oil is a quack remedy, some snake oils contain more omega-3 fatty acid than fish oil (“Quacks unite!”, March 6th). Research shows that fish oil is beneficial for

rheumatoid arthritis, psoriasis, cardiovascular disease, ulcerative colitis, manic-depression, migraines, menstrual pain, high blood pressure, sunburn prevention and other health problems. In fact, fish oil is so useful that it is in danger of being mislabelled “snake oil”.

Alan Gaby
Former president of the American Holistic Medical Association
Carlisle, Pennsylvania

A question of brotherhood

SIR – In your article on Islam you mention my work as a member of the European Council for Fatwa and Research, which offers guidance to Muslims living in Europe on social, moral and religious issues (“A growing band of brothers”, March 6th). You describe me as far from being a sympathiser of the Muslim Brotherhood. But if this is taken to imply that I feel some antipathy towards the Brotherhood it is misleading.

May I clarify this sensitive matter? I represent the traditional school of Muslim scholarship. On some issues considered by the council, I bring a perspective which is different from my colleagues who are more in line with the “juristic” or deductive approach in matters of *sharia*. But this does not imply any non-sympathy on my part for the Brotherhood's contribution to global Islamic work.

Suhaib Hasan
London

Swipes at Swissness

SIR – Not everybody considers the Swiss as God's gift to humankind; the country has a reputation for being stodgy, excessively conformist and excruciatingly boring. What your survey glosses over is the human cost of attempting to create quasi-perfect, sanitised and tightly regulated societies like those of Switzerland and Singapore (February 14th). Dig below the surface of Alpine placidity and you will encounter covert chauvinism, racism and die-hard xenophobia. Add to this a dour mien, high divorce rate, chronic drug problem, and page after page of shrinks listed in the phone book, and you begin to wonder whether Switzerland's claim to the highest living standard in the world can be justified.

Another Swiss trait is an innate and unquestioning tendency to identify with their country's institutions and sacred cows. This explains a surprisingly undemocratic habit in daily life of subordinating the needs and rights of the individual to those of companies, special-interest groups and other members of the establishment. In sum, Switzerland would benefit from an infusion of social enlightenment and culture—most of the latter is currently found in its delicious fruit yoghurt.

Steve Held
Zurich

SIR – Your view of Switzerland is more flattering and rosy than deserved. The militia system is characterised as getting a “big bang for its buck”. This is true only if you count government expenditure. The opportunity costs borne by the private sector are large. The rail-transport projects are political pyramids comparable to the Channel Tunnel. And how would you judge the future of a country that spends taxpayers' money on cows and school children at a ratio of one to three?

Direct democracy has its strong points. But too much of it makes the output of the political process more inconsistent and arbitrary. Britain may benefit from having a referendum once in a while. But Switzerland would definitely be better off by having fewer. Last but not least, the friendly hotel staff you mention must be a statistical oddity.

Silvio Borner
Basel

SIR – The EU and Switzerland can learn a lot from each other. Federalism and direct democracy, as well as respect and consideration for the interests of minorities and small cantons, are valuable concepts developed by Switzerland and used to the benefit of its people. If that means lower growth and a slower decision-making process, so be it.

Peter Widmer
Thalwil, Switzerland

Our Mafia “letter”

SIR – I find your letter, supposedly from Bernardo Provenzano, to be irritating and disturbing (“A capo's annual report”, March 6th). The Mafia is no joke.

Gianmarco Servetti
Bologna, Italy

SIR – Regarding Mr Provenzano's letter, I can only comment: “Grow up!”

Margherita Boniver
Under-secretary of state for foreign affairs
Rome

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Iraq, a year on

A glimmering of hope

Mar 18th 2004 | BAGHDAD AND CAIRO
From The Economist print edition

Getty

Though an awful lot has gone, and is going, wrong, Iraqis are much freer, and some other Arabs a tiny bit so too

SITTING cross-legged in his Abu Ghraib mosque, an island surrounded by sewage, Sheikh Yasseen Zubaie, the Sunni imam, remembers pre-war Iraq with nostalgia. “The council used to pump out the muck every three weeks. Now they promise, and do nothing,” he says.

War and occupation have made life harder for this town in the Sunni triangle west of Baghdad, where support for the insurgency is strongest. In addition to the sewage, townspeople live with dozens of Estonian troops guarding the market road. At night, power-cuts cloak the city in darkness, except for the arc-lights of Saddam Hussein's largest prison, where most of America's 11,000 prisoners are now detained. Sheikh Zubaie says all his children have diabetes, and he nods at the editorial of a Syrian newspaper now circulating in Iraq. “The foreign occupation of Iraq has destroyed its infrastructure, impoverished its people, dissolved its army and arrested thousands of its sons,” it reads.

The Iraq war was not as controversial as the Suez war of 1956, which felled a British prime minister, or Vietnam, which traumatised a generation. Yet the war divided both the world powers and world opinion. It claimed its first political victim, outside Iraq, when José María Aznar, Spain's prime minister who supported America's invasion and occupation, lost the election held last weekend, three days after bombs in Madrid killed 200 people. It may yet go on to claim the scalps of George Bush and Tony Blair, the war's chief architects. And, of course, it has changed the Middle East for ever. Was it worth it?

History, as usual, is reserving judgment. The war's critics are not. This war, they say, was illegal (neither self-defence nor authorised by the UN Security Council); unnecessary (Saddam seems not, after all, to have had weapons of mass destruction); and left Iraq worse off than before (his Iraq was at least not being torn apart by civil war). On top of this, it drove a wedge between America and much of Europe, added to Muslim suspicions of the West, and distracted attention from more urgent problems, such as the conflict in Palestine and the hunt for Osama bin Laden.

Some of these claims are fated to remain matters of opinion. Was the war legal? Britain and America claim that the series of Security Council resolutions violated by Iraq, fortified by a final one threatening “serious consequences” for non-compliance, permitted the resort to force. Was it necessary? The non-discovery of WMD has embarrassed the war's defenders. But after invading Kuwait, Saddam was not only under orders to dispose of WMD: he had also to prove he had done so. His failure to offer proof allowed the inference that he had something to hide.

Might prolonged inspections have provided a definitive all-clear? Maybe, but on past Iraqi form that might well have prompted another game of “cheat and retreat”. As to whether a WMD-armed Saddam would anyway have proved a danger to the region or beyond, nobody—mercifully—will now have to find out.

A change in Arab mood

However, not all of the much-debated questions about the wisdom of the war turn on imponderables. On some—such as the war's impact on the wellbeing of Iraqis and the consequences for the Middle East—the facts must have their say, even if they do not all point in the same direction.

For example, some of the war's critics predicted that it would unleash mayhem throughout the region, driving enraged Muslims into the arms of al-Qaeda and toppling friendly regimes like ninepins. Wrong: a rash of furious demonstrations struck Arab capitals during the war, and Islamist terrorism has increased sharply in Saudi Arabia and Morocco over the past year, but so far all regimes have survived.

Indeed, far from destabilising regimes friendly to America, the war may have had a salutary impact on unfriendly ones. Having lost an ally in Iraq and facing imminent American sanctions, Syria's Bashar Assad is striving to mend relations with the West, not least by offering a resumption of peace talks with Israel. The disarmament plans of Libya's Muammar Qaddafi may pre-date the war, but he has now not only dismantled secret weapons programmes, but shipped their parts to America. The Iranians reacted calmly to the removal of Saddam. They did not approve of it; but nor did they approve of him. And since the war they have made a show of being more open about their own nuclear activities.

A Year of Petitions

Those who predicted post-war mayhem in the region were mistaken. But those who expected a wave of reform to sweep the Middle East have not yet been proven right, either. No other tyranny has fallen, and no strides towards greater rights have yet been taken. And yet, although Muslims deeply resent America's plunge into Iraq, it has stirred hope as well as fear. Change is brewing across the whole swathe of territory from Pakistan to Morocco, on a scale not seen since the 1950s, when oil money and army-imposed political populism shook up the post-colonial order.

Much of the change is subtle, registered in shifting moods and vocabulary rather than in obvious action. Its roots generally lie not in the drama of Iraq, but in slower internal evolutions. Where Iraq has been a catalyst, this has often come not from a sense that America's initiative should be welcomed, but that reform is needed so as better to resist America's will, or to avoid Iraq's presently far from enviable fate. Still, whatever the reasons, the war has fostered a restiveness and impatience that is accelerating the region's political pulse.

The past year has seen peaceful anti-government demonstrations in Syria and Saudi Arabia, two of the world's most deeply calcified states. Though quickly dispersed, they were an unusual challenge. Only this month, Syrian campaigners were presenting a petition for sweeping liberalisation, a move that a decade ago might have landed all 7,000 signatories in jail. As for the Saudis, some refer to last year as the Year of Petitions, such was the number of drafts presented to the ruling family demanding representative government and civil rights.

Perhaps nothing will come of all this, but a number of Saudi taboos have disappeared. Debate of the role and rights of women and religious minorities is more open and intense than ever before. So is the soul-searching over religious extremism. Saudis themselves now speak of the problem of Wahhabism, a term they long dismissed as an Orientalist construct.

In Lebanon, long-muted misgivings over Syria's influence have grown louder. In Egypt, where economic slump has compounded the disgruntlement caused by years of political stagnation, the tone of criticism is increasingly strident. In a recent move to placate Egyptian journalists, President Hosni Mubarak suspended the imposition of jail terms for libel. The journalists welcomed this, but then had the impudence to demand the lifting of a host of other strictures on press freedom.

Such internal mutterings, along with pressure from the West, have clearly put the region's rulers on the defensive. Some have opted to pacify their detractors. The government of Sudan is well on its way to

concluding peace with southern rebels, following prodding by the United States. Keen to varnish their shabby human-rights images, the Egyptian and Saudi governments have both appointed boards to look into the issue.

A few smaller countries have been bolder. Qatar has initiated a radical overhaul of its education system. Oman has just appointed its first female cabinet minister, a step long ago taken by most Arab republics, but a precedent for the conservative Gulf monarchies.

The air of discontent has also filtered into inter-regional politics. What is sometimes referred to grandiosely as the “Arab system”—the web of institutions such as the Arab League, traditions such as annual summit meetings, and treaties that theoretically enhance regional defence, trade and human exchanges—has long been viewed as a hollow vessel. It has endured shocks before, but the Iraq adventure was seen as a particularly ominous debacle, as near-unanimous Arab opposition to American intervention translated into near-unanimous inaction.

Fearing its own extinction, the Arab League has therefore scrambled to gather support from members for the most far-reaching reforms since its founding in 1945. If the leaders who are to meet at an Arab summit in Tunis later this month agree, the changes could see the creation of several new institutions, including a pan-Arab parliament and court of justice, and a seven-member security council.

However, the summit is likely to be haunted by the question of democratic reform. A vague American programme of suggested reforms, the so-called Greater Middle East Initiative, has met with widespread hostility, reflecting both the nervousness of Arab rulers and their peoples' deep suspicions of the superpower. The initiative provoked a mass protest this month at the University of Menoufia, north of Cairo. Mr Mubarak has ridiculed the ideas as “push-button democracy” that would “open the doors to chaos”. Arab leaders say that America should concentrate on liberating the West Bank and Gaza from Israeli occupation before foisting new demands on the Arabs.

In light of the outcry, America is downplaying its draft initiative, perhaps hoping to let the flak settle before a multilateral relaunch at the G8 meeting in June. Meanwhile, Egypt, Saudi Arabia, Jordan and others are thinking of an Arab declaration to “spur individuals through participation”, which presumably means granting more political rights.

The biggest change of Arab hearts would come if democracy were to flourish in Iraq. But in the meantime the chaos there remains deeply disturbing to its neighbours. Even the minority of Arabs who welcomed the use of force to uproot Saddam have been shocked by the clumsiness of the occupation. The demons unleashed in Iraq, ranging from sectarianism to tribalism to *jihadism*, have caused some neighbours to suggest that their own stunted status quo may not be so bad.

But how bad is it, really?

The Iraqis themselves feel disorientated, but not necessarily unhopeful. The day Baghdad fell, Iraq went from being one of the world's most regulated societies to one of its least. An overweening state was stripped threadbare by looters, while the incoming American administrators watched like Nero at the burning of Rome.

But a nationwide opinion poll, sponsored by several broadcasting stations, shows that more than half the Iraqis asked believe that their life has improved compared with a year ago (see table). Two-thirds gave “regaining public security” as their priority for the coming year. This is all too understandable: for large swathes of Iraq, life in the absence of real authority is a game of Russian roulette. Insurgents strike where they will. Hundreds of Iraqis are slaughtered each month. Attacks by armed highwaymen are commonplace. Children, especially girls, are kidnapped and held for ransom.

But the end of the dictatorship has huge compensations. Unshackled from Saddam's command economy and 13 years of suffocating sanctions, the private sector is mushrooming. Amid the chaos, Iraqis have imported hundreds of thousands of cars, and millions of previously banned satellite dishes, computers, and

satellite and mobile phones.

A jumble of freedom

Freed from regulation, electronic and print media have transformed Iraq. A third of households have paid an average $100 for satellite dishes allowing them to tune into foreign (often anti-American) channels. Monitors have counted more than 230 new newspapers and magazines, 25 of them dailies. Hawkers peddle assortments of previously banned religious CDs, mixed up with Asian porn.

The prime beneficiaries of the consumer boom are the moneyed classes, throttled and evicted by the series of Iraqi revolutions that began in 1958. Exiled landowners are reclaiming appropriated estates. Also flocking home are the old landed and merchant Shias, whom Saddam labelled a Persian fifth-column and expelled to Iran.

The influx has caused land prices in Baghdad to multiply fivefold. Religious tourism floods across open borders: 48,000 Iraqis made the pilgrimage to Mecca this year, up from an average of 15,000 during Saddam's latter years. The construction sector is booming. From its near-collapsed base, Iraq's economy is probably the fastest growing in the world.

Freer, but mixed up

Iraqi public opinion, Feb 9th-28th, %
selected questions

How are things compared with a year ago?	
Better ***56.5***	Worse ***18.6***
How will things be one year from now?	
Better ***71.0***	Worse ***6.6***
How much confidence do you have in Iraq's...? *	
Religious leaders ***42.4***	Governing Council ***11.3***
Was it right or wrong that coalition forces invaded Iraq?	
Right ***48.2***	Wrong ***39.1***
Do you support or oppose the presence of coalition forces in Iraq?	
Support ***39.5***	Oppose ***50.9***
Which is the first priority for the country...? †	
Regaining public security ***64.4***	Holding national elections ***8.1***
What does Iraq need at this time...? †	
Democracy ***85.9***	A single strong leader ***81.1***

*% answering "A great deal" †Top two answers

Source: Oxford Research International/ BBC/ABC News/ARD/NHK

The Coalition Provisional Authority, Iraq's American-led civil service, struggles to make order out of this jumble. Its local and regional administrators require central approval for their spending plans, and are forced to lug briefcases to Baghdad to collect the cash for their budgets. Arguments over who controls the funds have delayed the Americans' $18.6 billion aid supplement. This had been billed as the panacea for unemployment, put by the CPA at 28% and by the World Bank at 50%.

On June 30th the CPA is supposed to hand over to an Iraqi administration. It, too, is likely to be highly centralised. By abolishing the army and security services, Paul Bremer, Iraq's American administrator, also abolished the country's biggest employer. Now the Americans are the largest employer. Iraqis continue to rely on the state to provide jobs, near-free electricity, landline telephones, food and the cheapest petrol in the world.

Fearful of the social consequences, Mr Bremer has shelved many plans for privatisation, and has bolstered the public sector. A couple working for the civil service can bring home $600 a month as opposed to $40 before the war.

Mr Bremer says electricity generation is back to pre-war levels, but many factories remain closed by power-cuts. Officials promise that the purchase of eight diesel power-turbines will push Iraq's supply from 4,000 megawatts to 6,000 (equivalent to the consumption of a single mid-size city, such as Baltimore) by the scorching summer. But the increase will not keep pace with soaring consumer demand.

Iraq's oil production has returned to pre-war levels of 2.5m b/d, thanks to an injection of $1 billion of American money. CPA officials say a further booster of $1.4 billion should push production to 3.5m b/d, just short of Iraq's maximum in the 1980s. This year, higher than expected oil prices should earn Iraq $14 billion-16 billion, up from $10 billion during the best years of sanctions. But predictions are vulnerable to sabotage. Each time the CPA says it is ready to reopen its northern pipeline to Turkey, a bomb shuts it down.

EPA

In early March, a missile attack severed international calls via a $50m telephone exchange Bechtel had built in Baghdad. The bloodshed has sapped investor confidence. The World Bank, which had been due to allocate its first tranche of donor aid last December, says it will not commit money until a handover of sovereignty, at the earliest. Insurgents have killed more than 150 non-coalition expatriate contractors, and NGO and UN staff.

All the same, some of the damage done during sanctions, the

war and after the war has been repaired. Looted ministries have new desks and carpets. The CPA successfully issued a new currency and has dreamed up the region's most liberal banking, investment and broadcasting laws. But pinned behind its concrete fortifications, the authority is often unable to implement its best intentions. Six out of ten households in urban Iraq are still without safe drinking water.

A soldier's job is never done

Like its economy, Iraq's post-war politics have advanced in fits and starts. America, strangely unprepared for the predictable complexities of occupation, has chopped and changed its plans. As of last week, Mr Bremer could at least boast that all the parties and factions on the Governing Council had signed an interim constitution that resolves—or at least papers over for the time being—vexed questions such as the role of Islam and relations between Iraq's Arabs and Kurds. In principle, this paves the way for the occupiers to “hand over” to Iraqis by America's self-imposed deadline of the end of June.

This handover will, however, be fairly notional. With too few police and no army to speak of, any new government will need foreign soldiers to protect it for a few years to come. Even now, with more than 100,000 American soldiers still on the ground, statistics suggest that the violence is growing.

One effect of this violence is to distance occupier and occupied. “Do not assume children are innocent,” reads the security advice USAID hands out to westerners. More than 600 policemen have been killed since the war. Ominously, militias, such as the Kurdish *peshmerga* and the Iranian-trained Shia Badr Corps, are expanding into the security vacuum.

And next?

As to the future, nobody can say. The war's critics have been quick to see in Iraq the pattern of Yugoslavia: the fall of a dictator allows an artificial state to fracture into warring nations—or perhaps to be unified again under the fist of a secular or religious tyranny. The war's defenders continue to hope that Iraq can prove the sceptics wrong, pioneering a modern Arab democracy and so helping to draw the sting of Islamic extremism. For the present, for all the bleakness of the view from Abu Ghraib, both alternatives look plausible.

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Foreign policy

America is from Mars, Europe is from Venus

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From The Economist print edition

Reuters

Yet more reason to worry about those Europeans

THE Bush administration did its best to take the Spanish election result in its stride. George Bush was one of the first world leaders to telephone José Luis Rodríguez Zapatero, Spain's prime-minister-elect, with his congratulations. Colin Powell insisted that "the Spanish people remain committed to the war against terrorists", while officials declared that they are offering Spain all the help they can to discover who was behind the bombings.

Yet the election result is clearly a serious blow. The withdrawal of Spanish troops from Iraq, if it comes to that, will have little military significance: Spain has only 1,300 troops there, compared with Poland's 2,500 and America's 150,000. But the loss of Spanish support for Mr Bush has big diplomatic ramifications.

José María Aznar's defeat not only removed the second-most-important American ally on Iraq after Britain's prime minister, Tony Blair. It also demonstrated that foreign leaders may pay a high price at home for their support for Mr Bush's war on terrorism. A year ago this week Mr Aznar stood at Mr Bush's side at a summit meeting in the Azores; now his country is led by a man who, during last October's Columbus Day military parade, made a point of sitting down as the American flag passed by, saying that "It's not my flag."

The fall of Spain's Popular Party severely limits the amount of pressure that America can put on its other allies, such as Britain and Poland. It also delivers a severe body-blow to American dreams of putting together a coalition of "New European" countries to counterbalance "Old European" places such as France and Germany (see article).

It is too early to judge what impact all this will have on the election race. The Democrats clearly have a good chance of using the Spanish election results to reinforce their claim that Mr Bush is alienating longstanding allies and thereby weakening the common stand on terrorism. But they need to handle this carefully. Howard Dean caused a furore when he told a group of reporters that Mr Bush's decision to send troops to Iraq contributed to the deaths in Madrid. The Kerry campaign immediately scrambled to dissociate itself from Mr Dean—and Democrats across the country offered thanks to God that they had not chosen him as their presidential candidate.

Even if they can avoid Dean-style gaffes, the Spanish debacle poses two serious problems for the Democrats. The first is that anything that puts the spotlight back on terrorism strengthens Mr Bush. A

recent *Washington Post*/ABC poll showed that Mr Kerry leads Mr Bush in eight policy areas, including the economy, education and health care; but Mr Bush leads Mr Kerry in the war on terrorism, by 21 points.

On March 14th Dick Cheney told an audience in Florence, Kentucky, that the bombings in Spain were "a reminder that there are evil people in the world, capable of any atrocity, and determined to take innocent life." He also criticised Mr Kerry for regarding terrorism mainly as a matter of law enforcement rather than military action. "He's embraced the strategy of the 1990s, which holds that when we are attacked, we ought to round up those directly responsible, put them on trial, and then call it a day."

Anything that puts the spotlight back on terrorism strengthens Mr Bush

The second problem for the Democrats is that many Americans interpreted the Spanish election result as evidence that it is dangerous to put too much faith in foreign countries. Dennis Hastert, the House speaker, spoke for rank-and-file Republicans when he accused the Spanish of "appeasement". But this line of argument was not confined to Republicans. American newspapers were full of laments that the Spanish electorate had responded to the attacks in Madrid in exactly the way that the terrorists had hoped—and replaced a pro-American government with one that is much softer on terrorism.

Edward Luttwak, a fierce critic of the war in Iraq, argued that the "Zapateros of Europe" are "bent on validating the crudest caricatures of 'old European' cowardly decadence". The more middle-of-the-road *Washington Post* wrote an editorial sharply critical of Romano Prodi's view that the events in Spain prove that force is not the answer to terrorism. "Should such sentiments prevail," the *Post* argued, "the next US administration—whether led by President Bush or Senator John F. Kerry—may have no alternative to unilateralism."

A few days after the Spanish election result, a comprehensive study by the Pew Global Attitudes Project provided yet further evidence that, when it comes to fighting, America really is from Mars and Europe from Venus. America is the only country where a majority of people (60%) favour the war in Iraq. Support for that war has plummeted in America's closest ally, Britain, from 61% last May to 43% today—and remains negligible across western Europe. Many people in France (57%) and Germany (49%) believe that America is exaggerating the threat of terrorism. There is strong and growing support across Europe for the European Union becoming a powerful counterweight to America.

Whether all this really leaves America with no alternative to unilateralism may be open to doubt. But both the United States and Europe clearly have a great deal of work to do if they are not to see transatlantic solidarity against Islamic terrorism dissolving in fratricidal dissent.

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Security on the railways

Keep on rolling

Mar 18th 2004 | NEW YORK AND WASHINGTON, DC
From The Economist print edition

Trains just aren't like planes

AP

Small comfort

PACK a pair of tweezers on you as you pass through airport security, and a gang of screeners surrounds you. Get on an American train and you can take as much of whatever you like, so long as it gets through the carriage door. Nothing much is going to change on America's railways and underground systems after the Madrid attacks. They are so vast, interconnected and open that the kind of screening used for airports would cost a fortune and bring parts of the country to a crawl.

From a statistical point of view, America has less to fear from terrorist attacks on trains: in the land of the car, people travel 12 times less on trains than in Europe. That is little comfort when you are in New York's Penn Station at the height of a weekday rush-hour. Then, some 500,000 commuters pour in from dozens of entrances to pass through to the long-distance, suburban and subway rail systems, all on various levels underground. There is little room to move, never mind navigate, along the platforms, and the waiting areas are packed. The handful of National Guardsmen and police officers patrolling Penn Station since the Madrid bombings provide reassurance, perhaps, but probably little else. Senator Charles Schumer of New York calls the station's main exit tunnel “a death trap”. As it happens, the Republican Party is due to hold its convention in August bang on top of the station, in Madison Square Garden. The Democrats will hold their convention above major subway lines in Boston.

New York, where nearly 9m train rides are taken each day, lies in the middle of a region, the north-eastern corridor between Washington and Boston, that relies heavily on rail. Even Washington's relatively modest subway system, the Metro, carries 650,000 passengers on an average weekday. Since September 11th, the Metro has received $50m in extra funding for things like sniffer dogs, extra police and chemical sensors hidden in stations. Still, it has a wish-list costing very much more. For instance, it wants a back-up control centre in the suburbs, should its downtown headquarters be disabled. Almost every transit authority in the country has been running up to Capitol Hill to beg for more funds.

New York's Metropolitan Transportation Authority (MTA) and police officials say that since September 11th, some 200 extra police officers have been assigned to the railways and subway. Closed-circuit cameras and radiation detectors have been installed. Last July, the state government approved a $600m security budget for the MTA. Vigilance on the part of rail employees and the public is urged. Yet city and state officials freely admit it is impossible to guarantee the vast system's safety.

As if to underscore the point, one deranged homeless man caused chaos beneath Manhattan just three weeks ago. By apparently throwing debris on to the subway rails, he caused a fire that disrupted five lines for hours. It took 40 minutes for the police to respond, and two hours for 1,000-odd people to be evacuated.

Michael Bloomberg, the city's mayor, who daily rides the subway, says that “the chance of a terrorist doing damage to you is a lot less than you getting hit by lightning.” Maybe he's right. Certainly it is doubtful whether added manpower does much to deter terrorist attempts. “It's all theatre,” says Bruce Schneier, a security expert, “not security. Uniforms just make the public feel better.” The MTA and the police say that as much as four-fifths of their security measures go on behind the scenes, but they cannot talk about that.

Even in those parts of America not dependent on passenger trains, terrorists could disrupt the freight network. In southern California, the railways shift well over $100 billion in goods a year. The Los Angeles County Economic Development Corporation reckons that a ten-day disruption from a terrorist attack would cost over $4 billion. The disruption of checking every container and truck might, in the long run, cost very much more.

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Detention in Guantánamo

Hell-hole or paradise?

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Returning detainees offer differing tales of life in Guantánamo Bay

DETAINEES shackled hand and foot for up to 15 hours at a time in wire cages open to rats, snakes and scorpions. A foul diet of yellow water and food up to ten years past its shelf-life. Interrogations at gunpoint. Sleep deprivation. Punishment beatings. Botched medical treatment. Amputations of limbs. Forced injections with unknown substances. Psychological torture. Humiliations, including the parading of naked prostitutes in front of devout Muslim prisoners.

This, and much, much more, is the picture of “unremitting cruelty” (as one human-rights activist described it) to which former British terror suspects say they were subjected during their two-year detention in Guantánamo Bay. The five men, who returned to Britain on March 8th, have gone into hiding after being released. But four of them have already talked to selected British newspapers.

In an interview with the *Daily Mirror*, Jamal al-Harith, a 37-year-old convert to Islam from Manchester, said that “the whole point of Guantánamo was to get to you psychologically. The beatings were not nearly as bad as the psychological torture. Bruises heal after a week, but the other stuff stays with you.” Three of the other released British detainees confirm Mr al-Harith's claims of frequent physical abuse and beatings. They had each been subject to more than 200 interrogations lasting up to 12 hours, they told the *Observer*.

Few of the 131 detainees let out of Guantánamo have chosen to speak about their experiences. Yet those who have tend to paint a very different picture. “Cuba was great!” 14-year-old Asadullah, one of three Afghan adolescents released from Guantánamo in January, told the *Guardian,* the *Observer*'s daily sister. His two fellow-detainees agreed. Prison life was good, the food delicious, the warders kind. They spent their days going to class, watching videos, playing football with their guards and learning about the solar system. They even went to the beach a couple of times. “I am lucky I went there, and now I miss it,” said Asadullah. He would like to live in America, if he could.

The three teenagers, aged 13-15 at the time of their arrest 14 months ago, were admittedly kept in a special facility—Camp Iguana, now closed—where their conditions were better than those of their elders in Camps Delta (high security), Four (medium security), and Echo, a new camp built to house those awaiting trial before military tribunals. The notorious Camp X-Ray, which held the first batch of detainees, was closed nearly two years ago.

But even some of the former adult detainees look back nostalgically on their lives in Guantánamo when compared with what they now face at home. “Of course they wanted to stay there,” Fatima Tekayeva, mother of one of the seven Russians transferred from Guantánamo into Russian custody last month, told another British daily, the *Times.* “They had human rights and good living standards there.” Russia's overcrowded jails are notorious for their beatings, torture, poor food and rampant TB.

So, hell-hole or paradise? While admitting that Guantánamo is no “resort”, the Bush administration insists that all the detainees are being treated “humanely, within the framework of the Geneva Conventions”, if not with full Geneva protections. They are housed in individual cells, each with its own metal bed, basin and stand-up toilet. They are given “culturally appropriate” meals (*halal* for Muslims), an opportunity for prayer five times a day, and the Koran along with “other reading material”. They also get daily showers and exercise and expert medical care, and can send and receive (censored) mail.

Few of the 131 detainees let out of Guantánamo have chosen to speak about their experiences

The Pentagon says that the British detainees' allegations are “simply not credible”. The United States

does not tolerate beatings, let alone torture. Detainees were not kept shackled in their cells. If only for security reasons, prostitutes were never allowed into Guantánamo. As for claims that they had been subject to unwanted injections, all the detainees were immunised against a range of tropical and infectious diseases when they first arrived.

It is difficult for an outsider to judge where the truth lies. There are virtually no independent witnesses. No human-rights groups have been allowed into Guantánamo, other than the International Committee of the Red Cross which does not usually report its findings. Reporters have been allowed in, but no contact was permitted with the detainees.

Yet a few facts have trickled out. Last year, the Red Cross broke its traditional silence to denounce the "unacceptable" situation in Guantánamo because of the lack of due process and the open-ended detentions. And earlier this month Human Rights Watch, a respected human-rights group, issued a report on Afghanistan in which it accused the Americans of carrying out arbitrary arrests, subjecting terror suspects to inhuman and degrading treatment, and of failing to explain the deaths of three detainees in its custody. While almost certainly largely fanciful, the stories from the British detainees in Guantánamo should not be entirely discounted.

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Climate change

Bottom-up greenery

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Local activism may force George Bush to take action on global warming

COULD the next grass-roots revolution in America be over climate change? George Bush stomped out of the UN's Kyoto treaty on global warming three years ago and did a U-turn on campaign pledges to regulate emissions of carbon dioxide (CO_2). Since then, he has refused to come up with sensible domestic policies. Yet that very obstinacy has fomented a backlash in the states.

Massachusetts led the way by imposing curbs on CO_2 emissions from power plants. The New England states have also joined the eastern provinces of Canada in vowing to cut emissions of greenhouse gases by 12% by the end of the decade. Emboldened by this, a dozen states and three cities sued the Environmental Protection Agency in October for refusing to treat CO_2, the chief greenhouse gas, as a pollutant.

Not to be outdone by Yankees, California, Oregon and Washington have now banded together to tackle climate change. California has passed the country's first law regulating emissions of greenhouse gases from cars. If the law survives legal challenges, New York and several other states, as well as Canada, have said they may do the same. A tough fight is coming; Governor Arnold Schwarzenegger says he isn't budging.

Does all this add up to a credible alternative to Kyoto? Not really. Climate change is not a local matter. Even the most innovative state is tightly linked to the energy-guzzling North American economy. Three years into their ten-year plan to curb emissions by 12%, for example, New Englanders have not managed to cut CO_2 emissions at all.

Still, this grass-roots revolt may yet succeed. For one thing, big business wants action. A report released this week by the Aspen Institute and the Pew Centre on Global Climate Change—two think-tanks that have discussed the matter with executives from the energy, mining and car industries—concludes that “a mandatory greenhouse gas reduction programme for the US could be both effective and politically feasible.”

An even better reason is the clamour for reform by Republican governors. In California, Massachusetts and New York it is Mr Bush's own allies making trouble. And at the federal level, it is Senator John McCain. His bill to force mandatory action on climate change lost a Senate vote late last year, but got an impressive 43 votes. He vows to keep introducing it until it passes.

Ultimately, argues Barry Rabe of the University of Michigan, the states may serve (as so often in the past) as laboratories for subsequent federal policy. And if the activity in the statehouses continues to bolster Mr McCain and other Republican rebels, national change could come sooner rather than later.

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Military strategy

The next American empire

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From The Economist print edition

George Bush and Donald Rumsfeld have pledged to change the way America's armed forces are distributed around the globe. What do they have in mind?

Get article background

WHEN the second world war and the Korean war had ended, America found itself in possession of what turned out to be some pretty useful territory. The bases used in the Japanese, European and Korean campaigns proved vital in the prosecution of the cold war. During it, the disposition of America's forces petrified, and large concentrations are still in Germany, South Korea and Japan. Now, as George Bush announced at the end of last year, that pattern is being re-thought, in advance of what Donald Rumsfeld, his defence secretary, grandiosely describes as the biggest restructuring of America's global forces since 1945. The outcome will intimate not only America's perception of the threats it faces in the new century, but also its attitude towards friends and alliances.

Three main factors are driving the review. The first is the emergence of new and unpredictable dangers—one of them manifest in Madrid last week. The Pentagon still worries about China and North Korea; about an India-Pakistan conflagration; and about the security of the Gulf. But alongside these concerns are the unknown unknowns of international terrorism, and an arc of post-cold-war instability that stretches from the Balkans to the Caucasus and around the Asian shore.

In the kinds of operations that these new threats may entail, American troops are less likely to have to “fight in place” on the plains of Germany than to get to remote regions quickly. And such wars and skirmishes may turn out to be as controversial as the ousting of Saddam Hussein. This means that America will need to rely on new allies in hitherto neglected regions, and avoid depending on bases in countries that might prove squeamish about pre-emption or prevention. Douglas Feith, a Pentagon official who is helping to conduct the review, says that there is no point having forces in places from which they can't be moved to the fight. The pre-Iraq international rancour is bound to inform such calculations, however much it is now said to be ancient history.

As these new threats have emerged, others have changed or receded—most obviously, Mr Hussein himself. His demise has already led to the withdrawal of most American forces from Saudi Arabia (an “occupation” famously anathema to Osama bin Laden), and the shifting of an air HQ from there to Qatar.

Then there is Kim Jong Il. The hollowing of North Korea's armed forces, and the growing competence and

confidence of South Korea's, mean that the South could defend itself much better than in the past against a conventional attack from the north. Plans have already been announced for the South to take over more responsibility from the Americans up near the demilitarised zone. Some in America, who worry that paternalism risks emasculating their country's allies (as well as needlessly consuming American resources), have long advocated such a handover. So some American assets will be moved down the peninsula, where they may be more use for other contingencies, as well as for a counter-attack in the event of an invasion. The main base outside Seoul—a source of friction with the locals, as are the cluster of marine bases on the claustrophobic Japanese island of Okinawa—will move too.

The second important factor is technology. Jobs such as surveillance and reconnaissance can increasingly be done from America itself (and from space). The lighter ground forces that America's army is hoping to field soon should be more easily deployable than today's tanks. The air force can do ever more damage with ever fewer planes. Enemy technology is also a consideration: adversaries may in future be more able and willing to attack American bases in volatile places with missiles and WMD, making those bases more vulnerable and more expensive to maintain.

Given this technological progress, one Pentagon mantra is that its involvement in a region should no longer be measured by the number of boots, tanks and aeroplanes that it has on the ground, but on its "capabilities"—ie, the force that it can bring to bear. That is just as well, since those boots are in short supply and high demand, another of the considerations that will help to shape the global review.

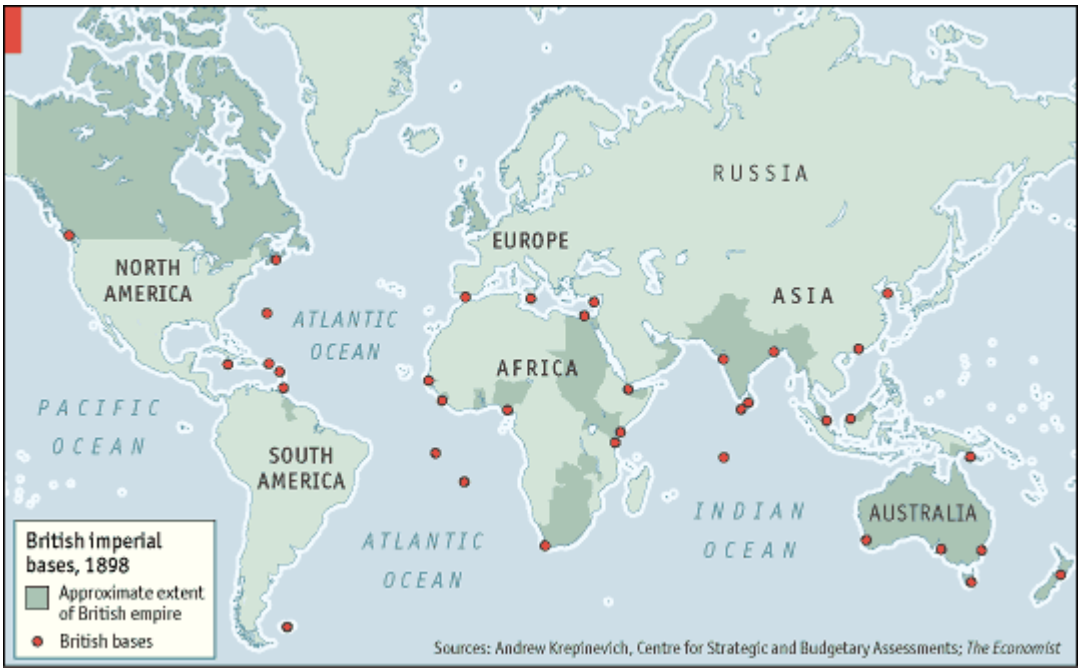
America's active-duty force shrunk by around a third during the 1990s—it now numbers around 1.4m altogether—even as the eruption of small, hot wars made it busier. Now the labour-intensive task of pacifying Iraq is straining America's army almost to breaking point. Before September 11th there was talk of further manpower cuts; many in Congress now want a statutory increase in the army's size. They argue that, as things stand, army recruitment and retention will suffer, especially after units who have already fought in Iraq are sent back.

Mr Rumsfeld is resisting these calls: his budget is coming under pressure; people are expensive and getting more so; and he would prefer to avoid a statutory force increase that would compromise the funds available for the modernisation (or "transformation") to which he is devoted. (Mr Rumsfeld's unconvincing answer to the Iraq problem is a temporary troop increase, under emergency powers, plus internal army restructuring.) But his global review will need to take account of these strains, as well as those induced by the ongoing deployments in Korea, the Balkans and Afghanistan.

Much ado about what?

In theory, the first two factors—new threats and technology—suggest a revised global "posture" in which, while retaining some large "hubs", America also develops smaller, dispersed bases in previously unconsidered regions, as it did in central Asia at the time of the Afghan war. Some of these could be lightly manned or even manless when not in use, and rapidly reinforced by air and sea in times of crisis. Andrew Krepinevich, of the Centre for Strategic and Budgetary Assessments, compares the frontier posts of the Roman empire, which could be (relatively) speedily reinforced by road (see Mr Krepinevich's maps below). Paul Wolfowitz, the deputy defence secretary, also talked recently about the importance, in the disparate "war on terror", of working with indigenous forces—as America did in Afghanistan, and as Britain regularly did when its own empire sprawled across the globe.

To be specific, Mr Rumsfeld has said there will be changes to the American presence in Japan—home to around 40,000 servicemen—and in South Korea and Germany (though the status of Ramstein air base there seems assured). Although he has also said that he doesn't plan many new bases, there are likely to be new facilities in the countries of his “new Europe”, which are closer to the Balkans and to central Asia than is “old Europe”.



Elsewhere, more Americans may wind up in Africa, and some of the Okinawa marines could conceivably be sent to northern Australia, where they will consolidate one of America's most durable alliances. New naval arrangements in Asia are also being considered. Bosnia will eventually be left to the Europeans. In time, the Pentagon may develop the futuristic concept of offshore bases, loosely based on oil platforms, which might help to circumvent diplomatic and “access” problems, though only up to a point. Meanwhile, more stocks may be pre-positioned in strategic places, and more servicemen—happily for them—will be based back in America.

What might the diplomatic consequences of such a re-jig be? Russia seems prepared to swallow an American presence in Bulgaria and Romania, which are keen on the jobs and extra security that hosting the Americans would bring (though the Russians would like to draw the line at the Baltics). Moving many of the 70,000-odd personnel and around 80,000 dependants based in Germany either east, or west across the Atlantic, will cost Germany jobs and, in the long term, might weaken an old alliance. Military co-operation acts as a ballast when diplomatic relations fray; less of it increases the chances of drift. Yet

some newer allies might be less than thrilled with the idea of hosting empty or near-empty bases. As John Hamre, a former deputy secretary of defence, puts it, such countries might ask: “If it isn't a permanent commitment of troops, is it a permanent commitment to our security?”

None of these decisions will be finalised until after an equally sensitive round of base closures in America itself is completed. But if the third important factor—the strain on the force—hasn't receded, the restructuring may turn out to be humbler than Mr Rumsfeld would like. Troops in Germany live in western comfort and with their families. Michael O'Hanlon of the Brookings Institution points out that shifting people to less salubrious bases in eastern Europe or elsewhere would increase the burden on an overstretched force, since those troops would have to be rotated back to America after their tours, with other units taking their place.

Mr Feith says this is a good time to review America's place(s) in the world, because the rationale for doing it is widely understood. But, because of Iraq, this may be the worst, as well as the best of times, to redesign the American empire.

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Going negative

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The pluses and minuses of George Bush's nasty campaign

EVER since his reincarnation on the plains of Iowa, John Kerry has been taunting his Republican opponents to “bring it on”. On March 12th the Republicans duly obliged with a swarm of attack ads, aired in 18 states, accusing Mr Kerry *inter alia* of being “wrong on taxes” and “wrong on defence”. And Mr Kerry's response? A masterpiece of wounded innocence. “Americans shouldn't have to put up with eight months of sniping,” he argued. Wouldn't it be better to have just a few debates later on, as Lincoln and Douglas did in the late summer of 1858?

This sort of hooey is par for the course in political campaigns, of course. The left has accused George Bush of every sin under the sun—from launching a war for oil to being a tool of a group of sinister Straussian philosophers. Mr Kerry seldom makes a speech these days without denouncing his opponent for “misleading America”. He was recently caught by a stray microphone telling factory workers in Chicago that the Republicans are “the most crooked, you know, lying group I've ever seen.” So much for the moral high ground.

The White House decision to go negative so early in the campaign is nevertheless significant. Mr Bush is not just using surrogates to savage his opponent, in the time-honoured fashion; he is doing the job himself, thereby summoning up the entire might of the presidential machine. This suggests, first, that Mr Bush's re-election campaign is in deep trouble; and second, that going negative has the potential to alter the dynamics of the race.

There are plenty of reasons why Mr Bush should have decided to turn nasty. One is that this year's campaign is stuck in fast-forward. One poll shows that 63% of Americans are following the presidential race more closely now than they were in the Octobers before the past two presidential elections. The other is that Mr Bush is sick of being used as a punch-bag. He's not only determined to punch back; he wants to land the blows himself.

But the biggest reason is that his campaign has got off to a disappointing start. There is no doubt that Mr Bush would have preferred to campaign as a middle-of-the-road Mr Nice Guy. This was the strategy that won him sweeping re-election as governor of Texas in 1998. And this was the strategy that brought him to the White House in 2000. Remember all the talk about “compassionate conservatism”? And the touchy-feely Republican convention in Philadelphia, with its blind mountain-climber and American-Samoan wrestling champion?

But in the past few months everything has conspired to keep Mr Bush from moving to the centre. The failure to discover weapons of mass destruction in Iraq has ensured that Mr Bush's war continues to polarise opinion. (Even Mel Gibson says he has doubts about voting for Mr Bush.) And the failure of the tax cuts to ignite jobs growth is making it more difficult for him to pose as the champion of the working man.

Mr Bush is also facing a fractious Republican Party at a time when the Democrats have rejected Howard Dean's "Democratic wing of the Democratic Party" in favour of Mr Kerry's broad church. The religious right had made it clear that it would withdraw its support unless it was given a constitutional marriage amendment. The small-government right has started screaming blue murder about ballooning bureaucracy. And the rank-and-file has started to worry that the White House is leading them to disaster. Larry Sabato, of the University of Virginia, claims that private polls show Mr Bush trailing John Kerry in Ohio, West Virginia, Florida and even Louisiana. *Time* magazine says that Barbara Bush is worried that "she has seen this movie before".

The White House may also be a victim of its decision to hold its convention so late—starting on August 30th, a full five weeks after the Democratic convention. The worry is that Mr Kerry will be able to solidify a positive impression in the public's mind in the next couple of months, before people turn off for the summer, and that the Republicans will not have enough time to redefine him after their convention.

The president's best chance

Can negative ads do anything to change these potentially disastrous political dynamics? The obvious risk is that Mr Bush will sacrifice some of the aura of the presidency by plunging into the mosh pit with the Bostonian. But this is surely outweighed by potential gains. The brutal fact about negative advertising is that it frequently works. George Bush senior, after all, used it to devastating effect on Michael Dukakis.

John Kerry is also the ideal victim for Mr Bush's hatchet-men. He leapt to the front of the Democratic pack in Iowa not because he stands for new ideas, as Bill Clinton did in 1992, but because he is an establishment figure with a commendable war record. He also has an awfully large number of potential negatives to contend with. He's a blue-blooded populist whose first wife was worth $300m and whose current wife may be worth twice that. He has the most liberal voting record in the Senate. He opposes the death penalty and supports steep petrol taxes. He has flip-flopped on a whole range of issues from dealing with Saddam to taking on the teachers' unions.

Mr Bush's decision to go negative is fraught with dangers. If he spends millions of dollars on negative advertising in the next few weeks without hurting John Kerry, he has little chance of damaging him later in the year. If some of the ads misfire, he risks poisoning his own reputation with floating voters. Mr Kerry will not stand idly by while he is being pummelled, and has already launched a furious counter-attack on the claim that he wants to raise taxes by $900 billion. But Mr Bush has little alternative. Attack ads not only represent his best chance to change the subject from his own record to Mr Kerry's; they are also his best chance of getting his own supporters to stop carping at him and start uniting against the common enemy.

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Ingrid Betancourt and Colombia's government

A symbol—but of what?

Mar 18th 2004 | BOGOTÁ
From The Economist print edition

AP

In Europe, Ingrid Betancourt's captivity is seen as an indictment of Colombia's government. To Colombians, she is just one of many victims of a conflict that their president (see article) reckons he's winning

Get article background

MARELBY AGATTÓN, who runs Colombia's Green Oxygen political movement, occupies a lonely cubicle in Bogotá surrounded by posters demanding the freeing of Ingrid Betancourt, the movement's kidnapped former presidential candidate. All of the posters are in French. In the local elections last October, Green Oxygen did poorly, electing only one mayor and ten councillors, although other leftish movements did well. Ms Agattón bemoans a lack of cash: Colombians haven't given a peso, so the movement relies on foreign donations.

Since her kidnap two years ago by the FARC guerrillas, Ms Betancourt has achieved mythical status in several European countries. There she is seen as a crusader for social justice against a corrupt and murderous political establishment—a Colombian Joan of Arc. In France, hundreds of town councils have adopted her as a "citizen of honour", as have others in Belgium and half a dozen further countries. That is tribute to a superbly organised campaign, led by Juan Carlos Lecompte, Ms Betancourt's current husband, an advertising executive. It is also because of Ms Betancourt's prior links to France. Her first marriage was to a French diplomat (she has dual nationality). Dominique de Villepin, France's foreign minister, is a friend and former tutor. Her book ("Until Death do us Part: My Struggle to Reclaim Colombia") is a bestseller in France.

Neither her book, nor her party, nor her crusade stirs Colombians in the same way. They see her not as a *cause celèbre*, but as a failed, minor politician, and only one among hundreds of kidnap victims being held by the FARC. The special attention she receives abroad provokes irritation. When María Jimena Duzán, a journalist, criticised Ms Betancourt's "deification" in a recent column in *El Tiempo*, Colombia's main daily, she received 400 e-mails, 70% of them in support. Ms Betancourt's book sold poorly in Colombia, wrote Ms Duzán, because it is "all lies" that make its author look good at the expense of Colombians. Far from being the country's only honest politician, she is herself a child of the establishment. She was never very radical, nor did she fight for the environment or against globalisation, as her supporters claim, wrote Ms Duzán.

Last year, Mr de Villepin organised a rescue attempt, sending a French plane and secret-service agents to the Brazilian jungle. He failed to tell either Brazil or Colombia. Now, Ms Betancourt's celebrity status has added to pressure on President Álvaro Uribe to negotiate a “humanitarian exchange” with the FARC.

In all, the FARC are thought to hold several hundred hostages, most of whom it tries to ransom. But they include 20 Colombian politicians, 37 policemen and soldiers and three Americans, captured when their drug-spraying plane was shot down last year. The FARC wants to swap some or all of these for some 300 of its members (including several mid-level commanders) who have been imprisoned.

Ms Betancourt's supporters want Mr Uribe to agree. So do some powerful Colombian political figures, such as Alfonso López, a former president, who is a friend of Ms Betancourt's mother. So, too, does the International Crisis Group, a Brussels-based lobby-group; in a report this month, it naively suggests that this could lay the ground for peace talks with the FARC.

In three years of talks under Mr Uribe's predecessor, the FARC showed no interest in peace or democracy. The government sees a prisoner swap as an invitation to further kidnaps, and as strengthening the FARC while granting it political recognition it does not deserve. Most Colombians agree: 61% oppose a “humanitarian accord”. So Mr Uribe has fixed two conditions: that the FARC release all its kidnap victims, and guarantee that its released prisoners do not return to the ranks. France offered to accept the released guerrillas. Unsurprisingly, the FARC refused this.

The fight over a “humanitarian accord” has become bitter and personal. Mr Lecompte this month left Colombia, saying that he had received death threats which he blamed on supporters of Mr Uribe.

The campaign for Ms Betancourt's release shows how little understanding her foreign supporters have of Colombia's conflicts. But its subject is an innocent woman who is monstrously confined, as are her fellow hostages. Her supporters should be deluging the FARC with demands for their unconditional release. Past prisoner swaps in Colombia have merely prolonged the country's agony. The hard truth is that there will be no peace in Colombia until the FARC is persuaded that it cannot take power by military means.

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Colombia's president

Uribe's barrage

Mar 18th 2004 | MIAMI
From The Economist print edition

Measuring a glass half-full

Get article background

A SLIGHT, rather modest and scholarly looking man enters the room. *The Economist*, interviewing him in the margins of a Latin American business conference run by a monthly magazine, *Poder*, wonders for a moment whether this is really Colombia's president, such is Álvaro Uribe's reputation as a tough, resolute opponent of the guerrillas, paramilitaries and drug barons that are the scourge of his country. But soon the finger is wagging aggressively, the eyes are gleaming, the decibels are rising. It's him, alright.

In keeping with his scholarly appearance, however, his conversation is a barrage of statistics, designed to illustrate the progress he has made since his election in 2002. The annual rate of arrests of suspected terrorists and paramilitaries has increased by 133%, including more than 700 arrested already this year. More than 4,700 have demobilised, far more than through past peace talks. Murders fell by 22% in 2003 compared with 2002 and kidnappings by 27%. But the numbers are still extraordinarily high: in the first two months of this year there were 3,290 murders, compared with 4,095 in the same months of 2003. He is thus not, he says, triumphalist.

Mr Uribe is keen to stress the importance of treating all the many groups of guerrillas (“terrorists”, he calls them) and paramilitaries equally. Any group willing to cease hostilities is welcome to have talks with the government. Otherwise, they face confrontation. He is stung by criticism that his approach to talks may be tantamount to offering impunity to murderers: the constitution, he stresses, prohibits the government from giving a pardon to anyone involved in atrocities. And he rejects vehemently the notion that he should consider a prisoner-trade over Ingrid Betancourt (see article): to do so would demoralise the armed forces and encourage further kidnappings.

The Colombian economy is, he thinks, benefiting from the fall in murders and kidnappings, with private investment rising as a share of GDP from 8% to 15% since Mr Uribe took office. The economy grew by 3.7% last year and a million new jobs were created. But unemployment remains high, at up to 17% of the labour force. And in the short term the aerial spraying of coca crops with weedkiller hurts farmers' incomes and spending: so far this year 30,000 hectares (74,000 acres) have been sprayed, following 90,000 that were sprayed in the whole of 2003.

The barrage of statistics is impressive and Mr Uribe plainly relishes it. Two questions, however, make him uncomfortable. Should the constitution be changed to allow presidents to serve more than one term? Not for him to say, he replies, he must be “prudent” on that topic; but he concedes that Colombia needs more continuity in the fight against terrorism than one four-year presidency can offer. And what is his view on the despotic behaviour of his Venezuelan neighbour, Hugo Chávez? Will he speak out against him and in favour of democracy? The president gets up abruptly from the sofa. It seems that we have run out of time.

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Canada's Conservatives

Harping on

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From The Economist print edition

A new leader for a revamped force

LAST autumn, as Paul Martin prepared to replace Jean Chrétien as Canada's prime minister, the divided right-wing parties were gloomily contemplating a second decade in opposition. So much has the political climate changed that the hurried merger of the Progressive Conservatives (PC) and the Canadian Alliance into a single Conservative Party has created a credible alternative to the Liberals.

The acceptable face of conservatism

The turnaround is partly due to the bursting of a sleaze scandal from the Chrétien era, concerning a publicity campaign against separatism in Quebec which degenerated into a slush fund. That has damaged the Liberals. But it is also because the Conservatives' tricky merger went surprisingly well, thanks mainly to the negotiating skill of Stephen Harper, the Alliance leader. Despite his party's ties to social and fiscal conservatism, he persuaded Peter Mackay, the more centrist PC leader, that merger offered each their only hope of power. Mr Harper now stands a good chance of defeating two rivals to become leader of the merged party in a grassroots vote on March 20th.

Though he grew up in Ontario, Mr Harper's base is in Alberta and the west. But he claims his role in the merger shows that he is a bridge-builder; he hints that he would offer the deputy-leader's job to Mr Mackay, who is from Nova Scotia. An economist who speaks fluent French, Mr Harper has tempered his past support for small government and a reduction in official bi-lingualism. Though 20 years younger than Mr Martin, he already has much parliamentary experience.

All of that gives him the edge over Tony Clement, who as Ontario's health minister dealt capably with last year's outbreak of the SARS respiratory disease in Toronto. The third candidate, Belinda Stronach, is an elegant political oddity. The chief executive of a car-parts firm, she makes a virtue of being a campaign novice. Her photogenic features have embellished the front pages for weeks. She stands slightly to the left of the other two on social policy, while promising to spend heavily on the armed forces. She has spent some of her fortune on signing up new party members in Quebec, a province that controls a quarter of the convention votes.

Whoever wins, the Conservatives will focus on ethical government and an assault on Liberal sleaze. All three leadership contenders also agree on the need for an elected Senate and some private health provision, and that the emotive subject of legalising same-sex marriages should be put to a parliamentary vote.

This spirit of unity means that the new party should come out of the convention having lost only a few “Red Tory” MPs such as Joe Clark, a former prime minister, while having gained 110,000 new members—and public support. The latest poll shows the Conservatives at 26%; the Liberals, at 38%, have slid ten points from their January peak.

That is worrying for Mr Martin. He had hoped to call an early election in May, partly to catch the newly-merged Conservatives before their policies were settled. Those plans have gone awry. On current polls, the Liberals would be reduced to a minority government. Never quick to take decisions, Mr Martin has called a by-election in Ottawa Centre, a difficult seat, for the distant date of November 29th. That suggests he might also postpone a general election until the autumn, giving time for the polls to change. Mr Harper, if it is he, has an opportunity.

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Haiti

If the shooting stops

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Political conflict will complicate the task of rebuilding a shattered country

Get article background

Reuters

Aristide returns in means-business class

THREE weeks after Jean-Bertrand Aristide was ousted as president of Haiti, his country has a new government. But it is not one of national unity, as had been promised; it is full of technocrats, some with impressive credentials, but includes no supporters of Mr Aristide. Even if the shooting stops, that may make the task of reconstruction harder. To underline his dissent from his country's new regime, Mr Aristide himself flew back this week from the distant Central African Republic to Jamaica, just 100 miles (160km) from Haiti.

Most of the jobs in the new cabinet have gone to the Group of 184, an umbrella group of business and civic groups and political parties opposed to Mr Aristide. No members of the former president's Lavalas party had applied, was the lame claim of Gérard Latortue, the prime minister.

But Mr Aristide, who claims he was the victim of a coup, continues to loom over Haiti. Thousands of youths (many armed) in the slums of the capital, Port-au-Prince, are still loyal to him. They have fired sporadically at the 2,700-strong multinational force, led by American marines and French troops, sent to the island by the United Nations. Six people have been killed, and one marine wounded.

The continuing violence is one reason why the United States' government is angry at Jamaica for having granted Mr Aristide a bolthole on a government farm on the north coast. He got further diplomatic support from Venezuela's Hugo Chávez, who offered him refuge. Mr Aristide has promised his hosts that he will stay out of politics, but his presence nearby is calculated to encourage his supporters to continue resisting. Already, the marines have abandoned their initial, passive, stance: they are now sweeping through the slums in armoured convoys, in a more aggressive attempt to stop the shooting.

Disarming the gunmen on both sides is the immediate priority. But it is only the first item on a daunting agenda. The deeper challenge is the desperation of life for youths in the Port-au-Prince slums, in a country where 80% are poor. What is needed, says David Lee, the representative of the Organisation of American States in Haiti, is policies that will “wean them off the gun culture”. As well as jobs in things like roadbuilding, he suggests offering rural smallholdings to slumdwellers. A stronger police force will be needed to deal with the drug traffickers and gang leaders who control the slums.

Then there is education. A million Haitian children do not go to school, says Jean-Claude Bajeux of the Group of 184. More teachers are needed, especially of languages. Only about 5% of Haiti's 8.5m people speak French; the others, who speak only Creole, have no access to sources of knowledge such as the internet. For Mr Bajeux, this is “the main factor preventing Haiti reaching modernisation.”

Andy Aped, a businessman who leads the Group of 184, says that if the rule of law is established, Haiti would start to develop. Its population makes it potentially as large a market as the Dominican Republic, its more successful neighbour. Under Mr Aristide, complains Mr Aped, “investments had to be submitted to a political agenda, and most business was done behind the palace doors.” As a result, he claims, “the private sector was functioning at only 20% of its potential.”

Many of the wealthiest and best-educated Haitians live abroad. The nation-builders could try and draw on

their resources. But establishing the rule of law is a far trickier matter than simply disarming the young toughs of the slums. And even that will be hard as long as Haiti remains divided between opponents and supporters of Mr Aristide.

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Mexico's politicians

Lies and videotape

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Televised misdeeds hurt a presidential front-runner

Get article background

THAT some of their politicians are corrupt is hardly news to Mexicans. But it is a novelty to see the misdeeds caught on video—especially when those concerned are sidekicks of the saintly mayor of Mexico City, Andrés Manuel López Obrador, the leftish front-runner for the presidential election in 2006.

First came the airing a fortnight ago of footage from a surveillance camera at the casino of the Bellagio hotel in Las Vegas. This showed Gustavo Ponce, Mexico City's finance secretary, in the pose of a carefree plutocrat, chewing on a fat cigar whilst gambling thousands of dollars at the blackjack tables. Such were Mr Ponce's means that he played only at tables where the minimum stake is $300—not easy on his official salary.

Mr Ponce has disappeared, but Mr López Obrador's problems have not. A second video showed a businessman and property developer, Carlos Ahumada, handing over wads of cash to the mayor's personal secretary and to the leader of his Party of the Democratic Revolution (PRD) in the city council. Yet another one showed another PRD city councillor stuffing thousands of dollars into shopping bags at Mr Ahumada's offices. Campaign donations, said the PRD men. Extortion, said friends of Mr Ahumada, who filmed the meetings himself.

Both accounts look lame. By law, politicians cannot accept any money from businessmen. Mr Ahumada was under investigation for fraud: he was paid 31m pesos ($2.8m) by the city government for work not done. Like Mr Ponce, Mr Ahumada is now on the run.

The outcry has forced Rosario Robles, a former mayor of Mexico City and former national leader of the PRD, to resign from the party. She had introduced Mr Ahumada to her colleagues. As for Mr López Obrador, he claims that the whole affair is a conspiracy to damage him; he points the finger at everyone from the United States' government to Carlos Salinas, a former president.

Maybe it is. The affair has hurt him, but so far not much. His approval rating has fallen by ten points, but from a stratospheric 82%. Mr López Obrador may hope that, come the election, Mexicans will have forgotten the videos. But his discomfiture has emboldened one of his rivals. Marta de Fox, the president's wife, felt free to deny her husband's assurance this week that in 2006 both would put their feet up at their ranch. “I haven't yet taken a decision” on whether to run, she said. In Martaspeak, that means she probably will.

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South Korea

A democracy holds its breath

Mar 18th 2004 | SEOUL
From The Economist print edition

MaxPPP

A reckless parliament has placed South Korea's fate in the hands of a court

Get article background

A STORM had been brewing for months, but the sudden political gust that swept President Roh Moo-hyun from office still took nearly everyone by surprise. Outraged by an impeachment vote on March 12th that seemed to defy common sense, tens of thousands of South Koreans took to the streets in anger against the country's two big opposition parties. The president's core contingent of ardent young supporters are not the only ones on the march. Many distraught protesters came from South Korea's moderate, usually apolitical, mainstream. They may not like the job Mr Roh has done during his first haphazard year in office; but they are incensed that the opposition has capriciously brushed aside the nation's elected leader.

Long suppressed under authoritarian regimes, South Koreans have enjoyed democracy with growing confidence since the late 1980s. And although Mr Roh's narrow election victory in December 2002 revealed deep and passionate rifts—ideological and generational—most South Koreans had been assuming that these differences would soon be dealt with at the polls: they are due to elect a new legislature in mid-April. So as the opposition parties rambled on last week about impeaching Mr Roh over an apparently innocuous public comment, most onlookers dismissed it as a stunt typical of South Korean politics, which usually involve lots of histrionics.

This changed quickly after Mr Roh held a defiant press conference on March 11th and, in effect, dared the parliament to challenge him. The next day, the conservative Grand National Party (GNP) persuaded several dozen of its wavering MPs to back impeachment. Within hours of the vote, Mr Roh was out of office, the prime minister stepped in as temporary head of state, and the impeachment motion was handed to the Constitutional Court.

In some ways, South Korea is now making it up as it goes along. Arguments have quickly emerged about the interim president's powers, and whether the opposition can add new charges to the impeachment motion. Local media are delving into the backgrounds of the nine judges on the Constitutional Court, who will decide on Mr Roh's case by a two-thirds majority. Three were appointed by the same political parties that have just voted for impeachment; another three by Mr Roh's predecessor, Kim Dae-jung, many of whose supporters have fallen out with Mr Roh; and the remaining third by the chief justice of the

Supreme Court. But despite the heavily political nature of the appointment system, the court's defenders say that it will operate above the fray.

If so, then Mr Roh has a good chance of landing back in office, since the core charge against him seems, on the face of it, ridiculous. He has been impeached for saying that he would do whatever is legally possible to help the Uri party, which backs him, gain seats in the election. Although presidents are barred from campaigning in legislative elections, this answer to a reporter's question was harmless. The president could face a stiffer test, however, if the court starts digging thoroughly into a corruption scandal that has engulfed close aides and family members.

For all the uncertainties, however, the country seems to have handled the first week of the storm well, with reassuring implications for its democracy. Despite a multinational stand-off over the nuclear programme in North Korea—which has accused the United States of being responsible for the political crisis and demanded that bilateral economic talks between North and South now be held on its territory rather than in the “unstable” South—and fierce differences of opinion over the role that American soldiers should play in South Korea, the alliance's ability to function has not been in doubt this week. The prevailing sentiment, moreover, is that peaceful protests and ballot boxes will see South Korea through its domestic crisis.

The electorate may now be itching to punish the Millennium Democratic Party (MDP), the main force behind the impeachment vote. The MDP seems to have risked everything in a last-ditch attempt to avoid extinction, following Uri's formation last year by defecting MDP lawmakers loyal to Mr Roh. In South Korea's personality-dominated politics, this left the MDP holding few levers of power (it has probably just pulled its last one). Many of its followers had already abandoned it before the impeachment vote, especially young voters in the sprawling conurbation around Seoul. Since the impeachment, many other MDP voters, who had been torn between their party and Mr Roh, now seem ready to back the Uri party.

The main opposition party, the GNP, was also expected to perform poorly at the polls—and has apparently chosen to gamble by ousting Mr Roh. Seven out of ten South Koreans oppose the impeachment. And the popularity of the Uri party, which was thrown out of parliament for physically trying to block the vote, has now soared above 50 percent, boosted by many previously undecided voters.

There is still a good chance, therefore, that South Korea will avoid a calamity. For now, demonstrators are taking pains to remain peaceful, for fear of losing the high ground. If the Uri party does well at the polls, as is now expected, and if the Constitutional Court, finding no proof of presidential corruption, decides there is really no case, then Mr Roh will find himself back in office, and a pair of reckless political parties will have been punished. The rifts in South Korea's electorate would remain, and Mr Roh might still run the country as incompetently as before. But South Koreans would emerge even more confident than before in the health of their democracy. Should the Constitutional Court vote against Mr Roh without a compelling reason, however, the storm could intensify and sweep away something far more precious than an unpopular president.

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China and Taiwan

Devil may care

Mar 18th 2004 | BEIJING
From The Economist print edition

Taiwan's elections, seen from the mainland

Get article background

FOUR years ago, China's then prime minister, Zhu Rongji, angrily warned voters in Taiwan that they wouldn't get “another opportunity to regret it” if they elected Chen Shui-bian, a supporter of the island's independence from China, as president. Mr Zhu's finger-wagging failed to deter them and on March 20th voters will have another opportunity: to re-elect Mr Chen or choose his opponent Lien Chan, who favours closer ties with China. This time China's attempts to influence the closely fought presidential race have been a little subtler.

At a rare news conference on March 14th, Mr Zhu's successor, Wen Jiabao, avoided threats of war. Instead he quoted lines from two Taiwanese authors expressing regret at the island's separation from China. “Only when the blood of the native son flows back to his native place will it stop boiling,” went one of them. About the strongest words he could summon to condemn Mr Chen (though not by name) were that the Taiwan leader's decision to hold a referendum on cross-strait issues at the same time as the election had “threatened stability in the Taiwan Strait region.” The remark is similar to those used by the United States, France, the European Union and Japan.

Chinese officials and the country's state-controlled media have also attacked the referendum as an attempt to set a precedent for an eventual vote on the island's formal independence from China. The referendum asks whether Taiwan should boost its defences in response to China's missile build-up and whether the island should hold peace talks with the mainland. But apart from the usual fulminations on internet bulletin boards (a haven for China's most ardent nationalists), there has been little sign on the mainland of great public concern about the issue.

This week, the government-affiliated Social Survey Institute of China published the results of an opinion poll on Taiwan's referendum conducted in cities around China. Curiously, more than 20% of the 2,150 respondents said they weren't interested. Li Dongmin, the institute's director, says that 5.6% even expressed tolerance of the idea of Taiwan's independence. This is a remarkable finding in a country where the government allows no questioning of its territorial claims, and a person's views on the Taiwan issue are regarded as a key test of patriotism.

Could it be that China's nationalists are going off the boil? Certainly many urban Chinese, when asked, support the idea of military action against Taiwan, should it declare independence. But for all the Chinese media's condemnations of Mr Chen as a traitor, grievances about his policies are far less likely to trigger public protests than are perceived provocations by Japan. This is partly a result of the government's fears that giving rein to public sentiment on Taiwan could force it to adopt a more confrontational approach, which would risk conflict with America and serious damage to the economy. Anti-Japanese protests are somewhat more tolerable because even the fiercest critics of Japan in China do not call for all-out war.

Mr Li says the government's own failure to articulate a clear-cut view on the referendum issue—beyond repetition of well-known formulas opposing independence—may also explain why some are becoming indifferent. Nationalist sentiment in China is shaped to a considerable degree by government attitudes. Few, for example, show any interest in taking Mongolia, which China regards as independent but which Taiwan officially regards as part of Chinese territory.

If Taiwan ever does declare formal independence, the risk of war would be considerable—hence the concerns expressed by several western governments about the referendum (or rather, what it could portend). But this week, French and Chinese destroyers staged joint manoeuvres off the Chinese coast,

the Chinese navy's biggest ever with a foreign country, according to the Chinese press. Taiwan expressed displeasure, but the exercise, as well as a goodwill port call to Shanghai by the command ship of America's Pacific fleet in February, suggested that for all the rhetoric, there is little immediate risk of conflict.

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About sponsorship

India and Pakistan

Musharraf bowls a bouncer

Mar 18th 2004 | DELHI
From The Economist print edition

Cricketing euphoria confronts political reality

Reuters

Batting beats battling

ASK most Indians and Pakistanis what is now the central issue in their two countries' relations, and the answer is simple: cricket. But Pakistan's president, General Pervez Musharraf, takes a more traditional view. The central or "core" issue, he insisted on March 13th, is Kashmir, the divided land claimed by both countries. Speaking by satellite to a conference in Delhi organised by *India Today*, a weekly magazine, this struck a jarring note. It was a reminder that a year-old peace process has made great strides in reducing tension, but none whatsoever in resolving the underlying dispute.

On March 13th in Karachi and March 16th in Rawalpindi, the two national teams played thrilling one-day cricket matches. Hundreds of millions in the two countries huddled in front of their television sets to indulge a shared national passion. This is India's first cricket tour of Pakistan since 1989, the year an insurgency in Indian-administered Kashmir broke out. It is one of a number of "confidence-building measures" since India's prime minister, Atal Behari Vajpayee, launched a peace initiative last May. None of the others—such as restoring full diplomatic relations, reopening direct air, road and rail links, and stepping up cultural exchanges—has had such an impact.

There were some fears that it might actually have counter-productive effects: a terrorist attack on the Indian team, or an outbreak of communal violence in India if Pakistan were to win and some alienated members of India's Muslim minority cheered the victory. But, with the series so far tied at one-all after two closely fought games, the enthusiasm is such that one might think peace had dawned.

It has not. But the cricket does at least provide an encouraging backdrop to eight sets of planned talks between senior officials on bilateral disputes. One set is to discuss Kashmir, but, in a painstakingly wrought diplomatic formula, the issue was accorded no "central" role. In insisting on the point, General Musharraf, who has what Salman Haider, a former head of India's diplomatic service, calls "a horrible habit of unexpected candour", provoked a tetchy Indian reaction. The two sides were back to the diplomatic sniping they seemed to have renounced.

In Kashmir, too, old habits linger. A ceasefire along the "line of control" between Indian and Pakistani Kashmir has been holding since November, and infiltration by Pakistan-trained militants has dried up. But until the snow melts in the high mountain passes, India will not know if this is a lasting trend. Pakistan has not dismantled the militants' training camps in its territory. Colin Powell, America's secretary of state, who visited Delhi and Islamabad this week, said he would raise the issue with General Musharraf.

Nor is there much to show for a dialogue that began in January between the Indian government and moderate Kashmiri separatists. Even before the first round, the talks had caused a split in separatist ranks. They have since subdivided again, because of complaints that expected gestures of goodwill from India—the release of detainees, an end to abuses by its soldiers, and even, perhaps, a ceasefire—have not materialised. Instead, India has succeeded in killing a number of leading militants. In return, terrorist attacks have persisted, including an attempt to murder the chief minister of the Indian state of Jammu & Kashmir. A second round of talks is still due on March 27th, but the flicker of optimism is extinguished.

This adds to the pressure on General Musharraf, criticised at home for winning no important concessions

from India, to take a hard line. “The task for Indian statesmanship,” argues Mr Haider, “is to let Musharraf emerge from this looking good.” Losing at cricket might help.

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Malaysia

Fighting for the heartland

Mar 18th 2004 | ALOR STAR
From The Economist print edition

Campaigning in the Malay belt

Get article background

ELECTIONS in Malaysia as a whole may not be cliffhangers, but in the state of Kedah they are. The last time the country went to the polls, in 1999, the ruling National Front coalition won a comfortable majority nationwide, as it has in every election since independence. But it lost eight of Kedah's 15 parliamentary seats, and 12 of the 36 seats in the state assembly, to the opposition Pan-Malaysia Islamic Party (PAS). What's more, an unusual number of seats on both sides were won by narrow margins. In the coming election on March 21st, too, the overall outcome is not in doubt: the National Front has already won nearly a tenth of parliamentary seats that are uncontested. But the standing—and job security—of Malaysia's new prime minister, Abdullah Ahmad Badawi, rests on improving the Front's showing in places such as Kedah.

The state is so fiercely contested because it is the most populous in the “Malay belt” of northern Malaysia, the spiritual homeland of the country's Malay majority. The United Malays National Organisation (UMNO), the main component of the National Front, considers it a point of pride to win a majority of the Malay vote. But Malays, as Muslims, are also susceptible to PAS's religious message. In 1999, for the first time, most of them voted against UMNO. PAS won control of Kelantan and Terengganu, two other states in the Malay heartland, and made inroads into Kedah.

PAS now espouses a domino theory, whereby it will wrest control of another state from UMNO at each election until it dominates parliament. UMNO, for its part, has drawn a line in the sand. Hence the all-out charge for Kedah. Every lamppost and pylon in the quiet agricultural state is now festooned with the two parties' banners. Mr Badawi flew in by helicopter on March 16th to open a new school. PAS leaders, in an even less subtle form of manipulation, have blithely declared that their supporters will earn a place in heaven, while those who vote against them are condemning themselves to hell.

Even with god on its side, PAS faces an uphill struggle though. For starters, UMNO has worked hard to improve its religious credentials. At campaign rallies around the state, leaders from both parties harp on about the Koran and utter incantations in Arabic. Mr Badawi's father was a respected religious scholar, and he himself studied Islam at university. Compared to his predecessor, Mahathir Mohamad, who took it upon himself to interpret the true meaning of the faith despite a relatively secular upbringing, Mr Badawi is the very image of learned and measured piety.

In fact, Dr Mahathir's retirement last year has boosted UMNO in several respects. The party's poor showing at the 1999 elections was due in part to his shoddy treatment of Anwar Ibrahim, the popular deputy prime minister of the day, who was sacked, imprisoned and beaten in the months before the vote. Although Mr Anwar still languishes in prison, the issue has gradually faded. Dr Mahathir also used to push grandiose construction projects and funnelled contracts to favoured businessmen, unpopular policies that fostered a culture of cronyism and corruption. Mr Badawi, by contrast, has scrapped several white elephants and initiated an anti-corruption drive.

Circumstances have also hurt PAS. Thanks to September 11th and subsequent bombings by militant Muslims in South-East Asia, Malaysian voters are naturally more suspicious of avowedly Islamic parties.

The country's economy, which was recovering from its worst ever recession in 1999, grew last year by a healthy 5.2%. Indeed, there are signs that PAS's star is already fading in Kedah. At a by-election in 2002, it lost a parliamentary seat in the state and only managed to retain another state seat by a whisker.

The electoral rules are also heavily stacked in the National Front's favour. Malaysia's first-past-the-post system translates small margins of victory into big parliamentary majorities. The eight-day campaign period has left the opposition with almost no time to raise its profile with the electorate. The media is unashamedly biased, with adulation of the ruling party interrupted only by dismissive digs at the opposition. The Election Commission, too, has redrawn districts in a manner that favours UMNO. In Kedah, for example, it helpfully moved an area that UMNO had won by over 5,000 votes in 1999 into a constituency that PAS had won by 3,000 votes. Of 26 new parliamentary seats, not one was awarded to Kedah, Kelantan or Terengganu, the states where PAS is strongest. The government, it seems, has more influence than god, even in a god-fearing state like Kedah.

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Indonesia

Business as usual

Mar 18th 2004 | JAKARTA
From The Economist print edition

Confusion and fluff in Indonesia's electoral campaign

Get article background

THIS should have been a seminal month in Indonesia's political history. The world's third-largest democracy is embarking on what United Nations experts are describing as the most ambitious electoral exercise ever attempted, with the introduction of new systems to elect the parliament, the upper chamber (itself a new creation) and the president. But a week into the 22-day campaign for the legislative election, it looks like politics as usual. Personality and religion are proving the only defining differences between the 24 competing parties, in a campaign where all policy debate is being drowned out by organisational snafus, allegations of corruption and campaign rule-breaking.

Many Indonesians have justified concerns over the sometimes farcical attempts to organise the polling days, starting on April 5th, when 15,276 seats will be filled in the parliament, upper chamber and local legislatures. There is more time for the election for president and vice president, scheduled for July 5th.

But anyone wanting to find out what the parties really stand for on issues such as health, education or separatism is struggling. Few parties have published detailed manifestos. The tiny minority of voters who bother to attend campaign events find them big on pop stars and light on substance. Choosing among candidates for the upper chamber will be even harder, as the candidates are not formally affiliated to any party and receive little publicity. So the only dividing lines are once again nationalism versus Islam, and more open democracy versus a return to the autocratic system of the Suharto era.

Predictions are therefore hazardous. Disillusionment with the party of President Megawati Sukarnoputri, the Indonesian Democratic Party of Struggle (PDI-P), which won the most votes in the last election in 1999, is certainly palpable. This is likely to favour Golkar, Suharto's former political machine that came second last time and has since tried to reinvent itself. The other potential winner could be the small but highly organised Islamic Prosperous Justice Party. Its gains, however, are likely to be at the expense of other, older and more traditional, Islamic parties rather than the nationalists.

Public confusion could also contribute to a political upset. For the first time, voters have to vote for both a parliamentary party and a candidate—a fact only 19% appear to understand, according to a recent survey—while different rules apply for the upper chamber and local polls.

In spite of the confusion, Indonesia's political landscape is likely to look much as it did after both the 1999 ballot and the only other free election, in 1955 (except for the seat allocation the security forces then had): Islamic parties will probably take about a third of the 550 parliamentary seats, with nationalists sharing the rest. This will by no means pre-determine the presidential poll though, unless the PDI-P and Golkar team up. After the surprise victory of Abdurrahman Wahid in 1999, nothing is being ruled out. But Miss Megawati, as the incumbent and daughter of Indonesia's founding president, is still, marginally, the front-runner.

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Afghanistan

A burning despair

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From The Economist print edition

Afghan women are setting themselves on fire

MALLALI NURZI had been thrashed by her mother-in-law once too often. She headed sobbing to the kitchen, poured petrol over herself and struck a match. Drawn by the screams, Mallali's daughter found her mother in a blur of orange flame. But the 26-year-old Afghan woman still took 24 hours to die.

It is hard to imagine a more agonising end, which makes the growing incidence of self-immolation in Afghanistan especially horrifying. According to a local human-rights group, at least 56 people have set themselves ablaze in Herat, a city in western Afghanistan, in the past year. Virtually all of them were young married, or soon-to-be-married, women, including a bride-to-be of 13 years.

Anecdotal evidence suggests the problem may be widespread, with several hundred young women igniting themselves in western Afghanistan each year. Mallali's grieving father, a former army colonel, says he knows of over 80 such suicides over the past two years, including that of another close relative. “There is not a village in Farah province where a young woman has not burned herself to death,” he says.

Afghanistan's women have long had many causes to despair. In an impoverished rural society, pubescent girls are bought and sold like cattle, and often treated little better. The toppling of the Taliban two years ago has hardly improved their lot. Parts of the country are now ruled by a rabble of equally conservative or lawless warlords. In fact, the number of young woman going up in flames seems to have risen since the Taliban's fall.

Rights workers blame the phenomenon, at least in part, on the blighting of educated women's hopes for a freer life after the Taliban. Significantly, several of the victims in Herat were teachers and nurses. Others were former refugees, who had grown accustomed to the relative freedom of life in Iran. Mallali had completed high school in Kabul and Iran. She was brought to despair after being forced to skivvy for her husband's entire family. “She was educated and sensitive,” says her father. “She found it hard to live like a slave.”

Afghanistan's new constitution affords equal rights to men and women. The warlords, however, do not seem to have noticed. Ismail Khan, the ruler of Herat, has expressed concern over the fiery suicides in his fief. He recently visited survivors in the city's hospital and commissioned a series of television programmes that seek to dissuade would-be self-immolators. In the meantime, women in Herat are still barred from riding taxis unaccompanied, or from learning to drive.

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Mercenaries in Africa

The fog and dogs of war

Mar 18th 2004 | JOHANNESBURG AND MALABO
From The Economist print edition

An alleged coup plot and its murky aftermath

IN A marketplace in Malabo, the capital of Equatorial Guinea, foreign traders cower. Since President Teodoro Obiang Nguema's government announced that it had foiled a foreign mercenary plot, the radio has been urging Guineans to report suspicious aliens, and the police have been rounding them up and beating them, or worse. A 12-year-old boy walks up to a shopkeeper from Benin and demands to see his papers. He has trouble reading them, and goes. “What hope is there for this country?” mutters the *Beninois*.

Mr Obiang is almost a parody of a despot. State radio likened him to God last year. His opponents can end up in jail, or roped to a bar in such a way that their forearms eventually break. Since his country struck oil, he has had a lot of cash to dole out. Rumours of plots against him are common, but this one was unusually dramatic.

On March 7th, some 70 men were nabbed in Zimbabwe, where their plane, which took off from South Africa, had allegedly stopped to load weapons en route for Equatorial Guinea. The men were mostly former members of “Battalion 32”, a disbanded elite South African military unit, some of whose other members staged a brief coup in São Tomé last year. The men were charged with conspiring to murder Mr Obiang, which they denied.

How were they caught? One theory is that South African spies tipped off their Zimbabwean counterparts after noticing dozens of ex-members of Battalion 32 training at a rifle range in Pretoria. Another is that a lowly security officer noticed that there were more men on the plane than the pilot had said there were. Robert Mugabe, Zimbabwe's president, seized on the incident as proof that western powers are bent on overthrowing splendid chaps such as himself. He did not dwell on the report that the alleged gunmen were buying their guns from the state-owned Zimbabwe Defence Industries.

A second group of 15-odd alleged mercenaries was arrested in Equatorial Guinea and accused of being the advance party. One, Nick du Toit, admitted on television to plans to oust the president and install an exiled rival, Severo Moto Nsa. The alleged motive was a share of renegotiated oil contracts. Mr Moto denies involvement.

Equatorial Guinea's information minister said the plot was orchestrated by a firm called Triple Options.

Documents obtained by *The Economist* suggest that this was a joint venture, formed for ordinary business purposes, between Mr du Toit and Armengol Ondo Nguema, the president's brother and secret-service chief, but the president denied his brother was in business with Mr du Toit, and Mr Armengol could not be reached for comment.

Greg Mills, of the South African Institute of International Affairs, argues that successful mercenary coups in Africa are a thing of the past. The African Union no longer recognises leaders who seize power by force. America is planning several small military bases in remote African spots, which are ostensibly for use against terrorists, but could also protect the superpower's growing oil interests in the region.

Tyrants cannot afford to relax, however. Their armies are often no match for coup-plotters with foreign expertise and weapons. Equatorial Guinea's had until recently just three armoured cars, though the oil money has bought more.

Many former soldiers want to work as mercenaries. Johann Smith, an expert on private military activity, estimates that some 3,000 well-qualified South Africans would be eager. The UN says hundreds serve as security experts in Iraq, and their less skilled compatriots have taken part in recent civil wars in Sierra Leone, Liberia and Côte d'Ivoire. Since 1998, South African law has forbidden mercenary activity, but not everyone is deterred.

It might be smart for governments to recruit some of these fighters. A growing lobby wants some private military activity to be recognised as legitimate. The American government allowed a firm called Military Professional Resources Incorporated, for example, to use former American soldiers to train Croatia's army. The same firm has long requested a licence to train the army of Equatorial Guinea, too. An umbrella group of nine military companies called the International Peace Operations Association argues that private firms can help keep the peace in unstable spots.

In Africa, the need for a bit more stability is obvious. Some UN staff say, privately, that private firms could supply effective peacekeepers more cheaply, quickly and willingly than African governments do. But African governments themselves remain wary of the dogs of war. Once bitten, twice shy.

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Electioneering in Congo

Deadly drag artists

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Congo's first proper election campaign will be dirty, but never dull

AFP

Things can only get better

EVEN by Congolese standards, it was a colourful allegation: three assassins dressed in women's clothing tried to shoot one of Congo's four vice-presidents last week. At the time of the alleged attack, Azarias Ruberwa was addressing a public meeting of women's-rights activists, so the killers presumably donned dresses to blend with the crowd.

Mr Ruberwa escaped through a back door, according to Francis Mabele, secretary-general of Mr Ruberwa's party, the Rally for Congolese Democracy-Goma faction (RCD-Goma). Two of the assassins escaped, and one is in custody, says Mr Mabele, though a top police official said he had heard nothing about it.

Whether true or not—and in Congo, such things are hard to fathom—the story does not seem to have won Mr Ruberwa much sympathy. His party was until recently a vicious rebel army, backed by Congo's hated neighbour, Rwanda. At the time of the alleged assassination attempt, many of the women in the audience were booing, heckling and contemptuously exposing body parts at him, in protest at the mass rapes his footsoldiers carried out during the civil war of 1998-2003.

That war is now officially over, and the main rebel groups have joined a transitional government. Elections are expected next year. The incumbent president, Joseph Kabila, looks the strongest contender, as he has the greatest powers of patronage and useful family ties to the mineral-rich region of Katanga.

His main rival is Jean-Pierre Bemba, another ex-rebel turned vice-president, whose men also committed atrocities during the war. Mr Bemba is better placed to campaign for the presidency than Mr Ruberwa because his current portfolio includes financial and economic affairs. He also has good connections with the still-wealthy cronies of Mobutu Sese Seko, the thieving dictator whom Mr Kabila's father overthrew in 1997.

At the proposed election, voters will probably be invited to choose a parliament as well as a president, but Congo has no tradition of legislators holding the executive to account. “The political system will be based on the presidency, with no real devolution of power,” predicts François Grignon, a regional analyst.

A visit to the transitional parliament does not inspire confidence. The red-carpeted stairs reek of sewage. MPs devote much of their time to negotiating their salaries, and to squabbling. President Kabila has reprimanded MPs for their idleness.

In addition, the country still remains highly unstable. After recent fighting in the lawless east between government loyalists and hardliners of the RCD-Goma, the latter threatened to pull out of the transitional government.

In Maniema province, in the east, thousands of Mai-Mai tribal warriors are supposed to be disarming, but hundreds have fled squalid demobilisation camps and headed back into the bush. In the northeastern district of Ituri, attacks against civilians are still common. Even Katanga, the president's home territory, is not safe. A Mai-Mai calling himself “The Ripper” has reportedly carried out massacres; his troops allegedly cut off their victims' genitals and drink their blood.

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Algeria's presidential election

Visas, please

Mar 18th 2004 | ALGIERS
From The Economist print edition

Many Algerians would rather emigrate than vote

SAMIA, at long last, has decided to leave her comfortable home and emigrate to France. She sat tight throughout the 1990s, when Algeria was ravaged by a war between Islamists and the security forces, in which 150,000 died. But, since gendarmes shot scores of demonstrators in her home region of Kabylia in 2001, she has lost faith in politics and all hope for change. A Muslim with a secular outlook, she fears for the future of her young daughters (she is shocked to see her nieces flirting with Islamism). On April 8th, when Algerians are supposed to elect their next president, she will stay at home.

So will many other Algerians. The discontent and frustration of the late 1980s, which led to the rise of the Islamic Salvation Front (FIS) and eventually to war, has settled, for many, into despair. Algeria has vast oil and gas riches, and its macroeconomic performance is praised. But unemployment remains at over 25%, and the gulf between the political leaders and the society that they are supposed to represent is as wide as ever.

Algeria's young feel as abandoned as they did in the 1980s. When France's president, Jacques Chirac, visited Algeria last year, the crowd was not shouting welcoming messages. It was demanding visas.

Yet there are good signs. The horrors of the war are over. Thousands of fighters took up President Abdelaziz Bouteflika's 1999 amnesty offer, and rejoined civilian life. In Algiers, where only a few years ago people were too frightened to go out after dark, youngsters in tight jeans stroll beside veiled women in crowded streets.

Many credit Mr Bouteflika for dragging Algeria out of its quasi-pariah status. Since September 11th 2001, the Algerian government has been accepted by the United States as a valuable ally in its war on terrorism. Although Islam remains the official state religion, the constitution now forbids using it as a political platform.

Mr Bouteflika is being challenged by five candidates, including a moderate Islamist, Abdallah Djaballah, the leader of El-Islah, which came second in the 2002 legislative elections with 9.5% of the votes. Crucially, the all-powerful army, which cancelled the election that the FIS was on the point of winning in 1991, and shoe-horned Mr Bouteflika into the presidency in 1999 after all the other candidates withdrew, has now officially declared its neutrality. A big change, if true.

Critics argue that behind the democratic façade, the old power system dominated by a few *decideurs* has not fundamentally changed. The country remains in the state of siege imposed in 1992, and the opposition accuses the president of using the national media, as well as state funds and the judiciary, as his campaign tools. The National Liberation Front (FLN), which long dominated politics, is weakened by a rift. Its leader, Ali Benflis, is running for president, but a rebel FLN faction supports Mr Bouteflika, and now, after a court decision and the sacking of a few judges, Mr Benflis's camp is unable to use the party's name or funds to campaign.

Saïd Sadi, a liberal-minded presidential hopeful, deplores the concentration of power in Mr Bouteflika's hands. Even so, he argues, conditions may at last be ripe for a genuine democratic transition—if the election is held without fraud. But, even if it is, will it satisfy all those jobless young men and women dreaming of a more comfortable life abroad?

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Basra and southern Iraq

Southern comfort, and discomfort

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From The Economist print edition

Are things really better in Basra?

“DAVID BECKHAM”, say the boys at the Imam Anas school near Basra, along with several less friendly and printable salutations. Saddam Hussein still peers out from their textbooks, but now he is adorned with irreverent schoolboy doodlings. According to their headmaster, the pupils apply themselves more avidly now that they know they will not inevitably be drafted into the armed forces. Beneath this boisterous optimism, is Iraq's second city as peaceful and unproblematic as, relatively speaking, it is often reputed to be?

En route to Basra's *souks*, a foot patrol from the Royal Regiment of Wales drops in at a police station to pick up some Iraqi policemen. On their rounds, the soldiers distribute leaflets encouraging the identification of terrorists. “Tony Blair good; Saddam Hussein bad,” says one pedlar. “Is there a reward?” asks another. Captain Geraint Davis says that the capture of an insurgent in Basra is more telling than in, say, Fallujah, since they have no local constituency and are less easily replaced. His men patrol in soft berets; when they wore hard helmets, one says, the Iraqis thought they were scared. Several squaddies say the American troops are too menacing, and too ready to resort to force.

AFP

The British teach Iraqis useful skills

To be sure, the Shia complexion of the population has made the coalition's job in and around Basra easier than in Baghdad. “We were dead, and now we are alive,” says one grateful employee at a new business centre in the port at Umm Qasr, a little way to the south. Still, British peacekeeping skills, honed in Northern Ireland and the Balkans, do seem to have helped to keep southern Iraq relatively calm. But only relatively: although the British have not lost a soldier to hostile fire since last summer, seven were injured, and three Iraqis killed, in a firefight earlier this month, and at least four people were killed by a bomb outside a Basra hotel on March 18th.

Most of the trouble, the soldiers maintain, comes from semi-organised criminals: smugglers whose lucrative trades have been disrupted where once they were tolerated, plus copper thieves, carjackers and kidnappers. The common-or-garden property crime that erupted after the war continues to distress the locals: “don't give us food; give us security,” says one disgruntled Basra florist. But there have also been political killings—on March 10th, two women working for a coalition contractor were murdered—and stand-offs with the assertive Shia militias. “We're the law here,” says Captain Davis. For now; but what happens when the British leave?

The televisions and air-conditioners piled up for sale in al-Hussein street, known to the troops as Electric Avenue, may exacerbate another problem. Basra's 1.4m or so residents occasionally enjoy 24-hour electricity; elsewhere in the region, it is much less reliable. Come high summer, more of those new appliances will be switched on. Patrick Nixon, head of the Coalition Provisional Authority in southern Iraq, says that the more help Iraqis receive, the higher their expectations become. Given the long-term neglect of Basra's infrastructure, plus the toll of sanctions and the widespread illegal tapping of supply lines, expectations about electricity could well be disappointed. When that happened last year, there were riots.

Another possible future source of trouble is unemployment, which is high in Basra, as it is elsewhere in

Iraq. Many of those who do have jobs work for the proliferating security services, or on another coalition payroll. The British forces spread some cash around by paying for small improvements: a new roof for the football stadium; a splash of paint for a mosque; the removal of some of the accumulated street filth, in which the city's children play barefoot. For those on these payrolls, salaries have leapt and times are good.

But their prosperity may prove temporary: a big cut in Basra's police force has been mooted. Overmanning, a legacy of Mr Hussein's regime, also afflicts the local, state-owned industries. A future Iraqi administration may decide that it can spend its growing oil revenues more productively than by lavishing them on bureaucrats. The football fans of Imam Anas may have to make their way without the paternalism which, vindictive or benign, has organised life in Basra for decades.

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Egypt's zealous police

Cairo's finest overdo it

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From The Economist print edition

Lacking terrorists, they nail less dangerous people

THE police in Egypt have much to be proud of. For a poor and crowded place, the country is remarkably free of crime. Terrorism plagues the rest of the globe. Here it hasn't struck this century, although there was a rough patch in the 1990s, when radical Islamists took to shooting tourists. The trouble is that, having swollen in numbers in order to face that threat, the police now seem to have trouble keeping busy.

Ask Yusef Rifaat, the owner of a small press in Cairo that prints, among other things, bumper stickers. He has just spent two weeks in custody for filling out a client's order for a set of stickers that poke fun at the city's chaotic traffic. His alleged crime was to have “besmirched the reputation of the security forces”.

Or ask Muhammad Nada, a 51 year-old construction boss. Last December, he spent a week in the slammer for daubing “No to inherited rule” on a wall—a reference to rumours that President Hosni Mubarak intends his son Gamal to succeed him.

In the past two years, 17 Egyptians have died in police custody; many more have been tortured. Human Rights Watch, a pressure group, reports that homosexuals are often entrapped, subjected to humiliating “forensic” examinations and given long jail terms for “debauchery”.

Other groups singled out include indigent street children and Shias, a small minority in Egypt. Police have also taken to snooping around Cairo art galleries, apparently in the hope of finding pornography or, better yet, blasphemous material.

The rich and powerful are feeling the pinch, too: several have recently been convicted of corruption. Fair enough, perhaps, but the scale and tenor of prosecutions has so chilled Egypt's business atmosphere that many bankers have ceased lending, for fear they could be branded criminals if their clients default.

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Spain, a week on

An election bombshell

Mar 18th 2004 | MADRID
From The Economist print edition

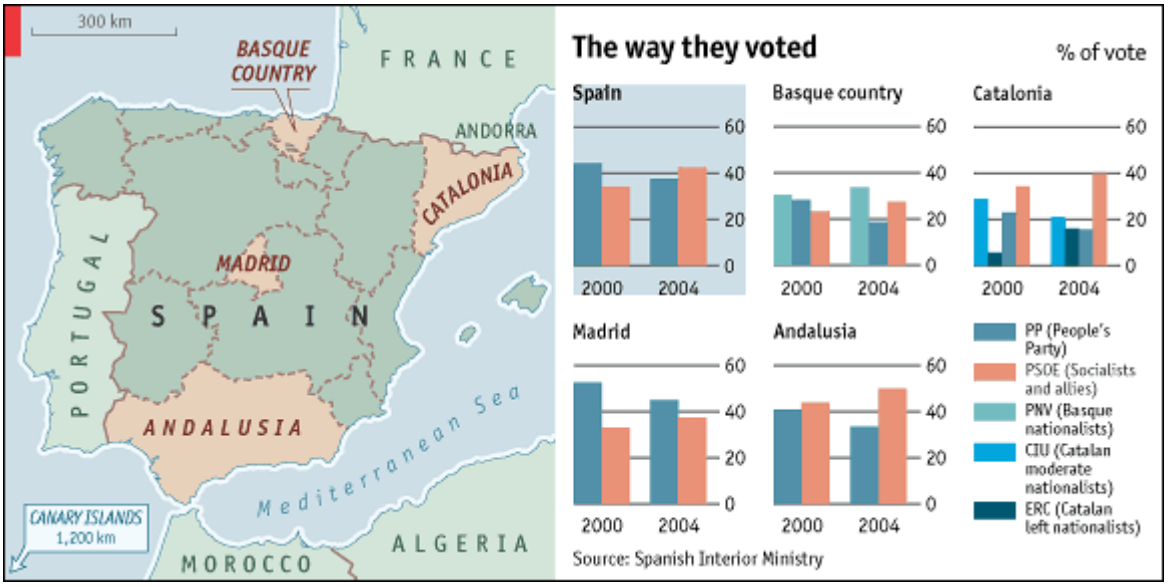
AFP

The surprise election victory of the Socialists, under José Luis Rodríguez Zapatero, has changed Spain's—and Europe's—political map

BY UNEXPECTEDLY returning the Socialists to power, the Spanish election on March 14th has delivered almost as big a shock to Spain, and the world, as the train bombings in Madrid did three days earlier. But, though many were quick to accuse Spanish voters of appeasement in the face of terror, the truth of what happened and what it means is more complex.

The March 11th bombings merit first attention. The death toll is now 201, making this the most savage attack that Spain has suffered since the civil war of 1936-39. At first it was blamed by the People's Party (PP) government of José María Aznar on the Basque terrorist group, ETA, which was known to be planning a spectacular outrage in Madrid. But all later evidence has pointed to Islamist terrorists, possibly linked to al-Qaeda (see article).

The cack-handed attempt to blame ETA, combined with renewed doubts over Mr Aznar's support for the war in Iraq, turned the election round. Though the party's lead had been narrowing, opinion polls had pointed to a win for the PP, under Mr Aznar's hand-picked successor, Mariano Rajoy. In the event, the Socialists under José Luis Rodríguez Zapatero won 42.6% of the votes and 164 seats in the 350-seat Cortes, a big jump from the 125 it won in 2000. The PP got only 37.6% of the votes and 148 seats, down from 183 in 2000. Turnout rose to 77%, from 69% in 2000.



The result sent tremors round the world, especially when Mr Zapatero's first announcement as prospective prime minister was that he would, as promised, withdraw Spanish troops from Iraq. He unceremoniously reproached George Bush and Tony Blair for going to war “on the basis of lies”. And he promised a more emollient approach to old European Union allies, delighting France and Germany.

What caused the upheaval? A frightened and disorientated electorate voted with a knee-jerk reaction, said senior PP officials. The voters have done the work of al-Qaeda, some added bitterly. In that the bombings changed the result, they were right. But the underlying reasons may be less flattering to the PP.

The biggest was the three days when the government and the heavily state-influenced media insisted that ETA was the culprit. The assumption was that, if it was ETA, that would be good for the PP,as it would vindicate Mr Aznar's hardline stand against both terrorism and Basque separatism; but if it was an Islamic terrorist group, the PP would suffer, because 90% of Spaniards had opposed the war in Iraq. “A critical point was reached in a spectacular way. We stressed for years: the PP are lying and distorting the truth. It took an important time, when people needed the truth, to discover the level of manipulation, and that day was March 11th,” says Juan Fernando Lopez Aguilar, a confidant of Mr Zapatero and member of the Socialist Party's national executive.

The second important factor was higher turnout. The emotional impact of the bombings seems to have persuaded many Spaniards to do their democratic duty and vote. Most were hitherto dormant Socialist supporters. As many as 2m were new young voters, who came of age during Mr Aznar's mishandling of the *Prestige* oil spill in 2002 and the subsequent war on Iraq. “For the first time in 10-15 years, the majority of 18-30-year olds were voting for the Socialists, but again the message that people wanted change did not surface, because of the PP's stranglehold on the media,” says Mr Lopez Aguilar.

Also, after eight years of the PP and a growing fatigue over Mr Aznar's authoritarian style, Mr Rajoy's chances of winning may never have been as sure as they looked. The bid to sell him as the same product but with an improved tone did not mobilise voters. The PP even began to believe its own propaganda. Strangely, so did everybody else: it was no secret that hardly anyone in the Socialist camp expected to win. Yet Mr Aznar was never as personally popular as his charismatic Socialist predecessor, Felipe González. In a crisis, people proved ready to back away from him and his party.

In Catalonia and the Basque country, both the blaming of the bombings on ETA and Mr Aznar's fierce anti-regional rhetoric backfired spectacularly. His government demonised the Socialists when their coalition partner in the Catalan regional government, the Catalan Republican Left (ERC), was found to have done a secret deal that led ETA to declare a ceasefire limited to Catalonia. The ERC jumped to fourth political power in Spain, with eight seats in the Cortes, up from one in 2000. In Catalonia the Socialists won almost four times as many seats as the PP, which has now become almost a fringe party in the region. In the Basque country, the PP slumped from second to third, behind both PNV nationalists and Socialists.

Mr Zapatero, known for his youth as Bambi, will form a minority government that will function, like some previous governments, by forming informal alliances with nationalist and left-wing parties. He lacks the

fiery rhetoric of Mr González, who was prime minister from 1982 to 1996. But his style is attractive after the years of bad blood created by Mr Aznar's high-handed manner.

In a marked change, Mr Zapatero telephoned the Basque leader, Juan José Ibarretxe, instantly restoring relations between Madrid and the region. Mr Aznar had not spoken to Mr Ibarretxe since 2001. Mr Zapatero's first statements on foreign policy signalled that Spain would return to its old loyalties in Europe (see article) rather than its newer pro-American stance. He also wants to revive the notion of Spain as a link between Latin America and the EU.

Mr Zapatero's domestic policy is less clear. Before the election, he appointed a committee of *notables* who are a mixture of new savvy and safe old guard. According to his circle, Miguel Sebastián, who is not a party member, will be finance minister. An economist and a former banker, he wants to reduce government intervention in business, combat tax fraud and support innovation, research and development. But the new government may also reintroduce labour-market regulations that Mr Aznar had sensibly junked.

Elsewhere José Bono, regional president of Castile La Mancha and a party strongman, is expected to be security minister. Javier Solana may be recalled from Brussels to be foreign minister. Jesus Caldera, Mr Zapatero's right-hand man, will surely have a plum job; a grand old man of the left, Gregorio Peces Barba, could head the culture ministry; María Jesús Sansegundo will get education.

Optimistic Socialist voters talk of a second democratic transition. Areas where Mr Aznar had failed to make improvements, such as government control of the powerful state media and Madrid's testy relations with the regions, may see early action. As crowds gathered to celebrate Mr Zapatero's victory in Madrid, hundreds of young people chanted: “Don't let us down!” No doubt he will try not to; but assuming office when his country has just been bloodied by international terrorists will present a huge challenge to an inexperienced prime minister.

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Al-Qaeda

The hydra bites

Mar 18th 2004
From The Economist print edition

Al-Qaeda is not the beast it was before September 11th. But it is still deadly

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FROM an unexploded bomb in a backpack to a tatty Madrid phone shop, and onwards to Morocco and beyond. The investigative trail from the March 11th bombings in Spain, though fuzzy, points to the involvement of Islamist fanatics, and now stretches over the Spanish borders. The Americans say that al-Qaeda itself was involved; Osama bin Laden, keen to portray himself as the vanguard of a global *jihad*, will doubtless be pleased with this conclusion. For westerners, the theory that Mr bin Laden had a hand in this and other recent attacks at least helps to make an otherwise mystifying enemy seem comprehensible. But is it credible?

Perhaps. Jamal Zougam, a Moroccan arrested in Spain last week, is thought to be an associate of Abu Dahdah, who was himself believed, until his arrest in late 2001, to have been al-Qaeda's top man in Spain. Mohammed Atta visited Spain not long before he led the September 11th attacks in America. Mr Zougam and Mr Dahdah may have liaised with other extremists across Europe, and with a group believed by the Moroccan security services to have sent the suicide bombers who struck Casablanca last May. There are whisperings of a connection to Ansar al-Islam, an outfit once based in northern Iraq, and also to Abu Musab al-Zarqawi, a Jordanian accused of orchestrating the carnage in Baghdad and Karbala earlier this month.

Yet to talk of al-Qaeda responsibility risks misunderstanding the methods that Mr bin Laden's movement has adopted since losing its Afghan sanctuary in 2001. According to American counter-terrorism officials, nearly 3,500 suspected al-Qaeda sympathisers have been detained, in over 100 countries, since September 11th (though some have later been released). Two-thirds of al-Qaeda's known senior leadership has been “incapacitated”, the Americans claim. Mr bin Laden and Ayman al-Zawahiri, his right-hand man, may now be principally preoccupied with saving their own skins.

Given these disruptions, the threat now comes from what George Tenet, head of the CIA, recently termed “a loose collection of regional networks that operate more autonomously” and “a global movement infected by al-Qaeda's radical agenda”. Tens of thousands of graduates from al-Qaeda's Afghan camps have dispersed around the world, taking with them both an apocalyptic philosophy and a deadly expertise. Some may have drawn advice, cash or personnel from Mr bin Laden's inner circle, or from each other; some may take cues from his taped exhortations. But a few may derive nothing more than inspiration from him. Even Mr bin Laden's death or capture is unlikely to defang these disciples. (Intelligence sources are sceptical about claims of co-operation between such terrorists and secular ones such as ETA, even if their use of the same suppliers superficially points to just such a link in Spain.)

By its nature, such a diffuse movement is much harder to monitor than a unitary organisation: witness the apparent lack of any advance intelligence about the Madrid plot. It is also unpredictable in its tactics. Mr bin Laden's cadre has shown considerable flexibility, variously deploying planes, trucks and boats as weapons. But suicide has been a consistent method. Yet the Madrid bombers appear to have eschewed it, though the simultaneity and wantonly indiscriminate lethality of the attacks were familiar. A *jihadi* website that discussed ways of dislodging the Spanish from Iraq mentioned the elections. The timing of the strike, just before the poll, may also signal a new tactic.

Where might this hydra bite next? Perhaps because of limited resources, perhaps because of “target-hardening” in rich countries, the terrorists have since September 11th hit mainly “soft” targets, such as tourist and religious sites, often in poorer (and Muslim) countries. They have forgone the symbolism of assailing embassies, ships and skyscrapers, but killed infidels where possible, murdering German tourists

in Tunisia, French engineers in Pakistan and Australians in Bali. They have also turned on Saudi Arabia—at the behest, the Saudis believe, of Mr bin Laden himself. Madrid was, however, the first Islamist spectacular in western Europe.

One theory is that Spain became a target after it cracked down on militants whom it had previously tolerated. Something similar may be brewing in Britain, historically a haven for Islamists (especially in what is derisively known as “Londonistan”). Like Spain, Britain has been excoriated by Mr bin Laden, and it has troops in Iraq. British interests have been targeted in Istanbul; but it has not yet been hit directly. British politicians and police see that exemption as temporary: gloomy warnings were issued this week.

On the other hand, Mr bin Laden and his ilk bear ancient as well as contemporary grudges. Mr al-Zawahiri calls the Spanish reconquest of Granada in 1492 “the tragedy of al-Andalus”. Other countries with no involvement in Iraq could be imperilled. As Mr Tenet says, future strikes may involve aircraft, or poisons and chemicals; Mr bin Laden sees the acquisition of nuclear weapons as a religious duty. Shipping is another risk. In 2002, Morocco arrested a gang thought to be planning to attack NATO ships in the straits of Gibraltar.

European officials are considering if there is anything more they can do to avert such catastrophes. Airport-type security checks on some trains are likely, as are more random checks of baggage and cars, and the removal of litter bins that might serve as bomb receptacles—the sort of grinding measures Britain adopted during the IRA peril. That, plus a continent-wide crossing of fingers.

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France and terrorism

Opted in

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The idea that there are al-Qaeda opt-outs does not stand up

COULD opposition to the war in Iraq act as insurance against future al-Qaeda terrorist attacks? This theory did the rounds in such peacenik countries as France, Germany and Belgium after the Madrid bombs. But in truth these places are as vulnerable as anywhere.

The argument that France could be less exposed rested on the symbolic value of President Jacques Chirac's hostility to the war in Iraq, for which he was cheered in the Arab world. More concretely, France has been cited less often in al-Qaeda tapes, while those with troops in Iraq, notably America, Britain, Spain and Poland, have been picked out.

Moreover, the French have been monitoring, and to an extent containing, Islamic terrorism for years. Algerian terrorists planted bombs in Paris and Lyons in 1995-96, two of them deadly. Since then, France has been quick to put into effect longstanding plans to deploy all its security forces at times of high alert. With Europe's biggest Muslim population (some 4.5m), France has long had mosques and clandestine prayer halls under surveillance. Since September 11th, there have been some 150 arrests in France linked to Islamic terrorism.

Yet any complacency would be misplaced. France may not be “specifically targeted”, said Mr Chirac this week, but it “was not sheltered from terrorist acts”. The government raised the security alert in railway stations and airports to red, the second-highest level. With 32,000 km of railways, the French network is second in Europe only to Germany's. Inspectors were already combing the tracks for bombs, after the government received a bizarre blackmail threat from a previously unknown terrorist group, AZF. Since the Madrid attacks, French soldiers have been patrolling stations; metal covers have been fixed on litter bins on the metro; and plain-clothed agents have been put on the railways.

Recent messages explicitly threatening France are causing the greatest concern. This week, a letter from a hitherto unknown group called “The Servants of Allah, the Powerful and the Wise”, was sent to Jean-Pierre Raffarin, the prime minister, and two French newspapers, threatening to “plunge France into terror and remorse”. France lost its place as a friend of Islam, the group said, by banning the Muslim headscarf in state schools. This message came weeks after Ayman al-Zawahiri, al-Qaeda's number two, singled out the headscarf ban as more evidence of “the grudge the western crusaders have against Islam”.

Doubts remain about the authenticity of the latest letters, but the French take all warnings seriously. Intelligence sources say Italy and Britain are more likely targets, but France is on the list, and not just because of the headscarf. French special forces have been working alongside Americans in Afghanistan. “Al-Qaeda is opportunistic rather than strategic,” says Olivier Roy, a French specialist on Islam. “In France, it would find an argument to legitimise an attack.”

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Denmark

Unpopularity begins at home

Mar 18th 2004 | COPENHAGEN
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The Danish prime minister loses even more support

AFP

Rasmussen before the fall

THE risk that al-Qaeda terrorists may be going for countries that joined the American-led war on Iraq is worrying Britons, Italians and Poles. But it has not yet sunk in among Danes. Just 48 hours after bombs ripped through trains in Madrid, customers were evacuated from a big Copenhagen Ikea store. It turned out to be a false alarm, but the reaction was telling: customers ambled out slowly and mulled around the entrance smoking cigarettes. Nobody ran. Nobody made any link between Spain's involvement in Iraq and Denmark's strong support for the war.

This relaxed attitude could change. Only five countries—America, Australia, Britain, Denmark and Poland—sent fighting troops to the war against Saddam Hussein. The Danish contribution of a small battleship and a submarine cast the country as a belligerent for the first time since 1864. After the Madrid bombings, all five bar Denmark stepped up security. The left-wing opposition has duly called for the withdrawal of the 500 Danish troops in Iraq, following Spain's example, but the government insists they should stay.

This pledge of allegiance to America could prove costly for Anders Fogh Rasmussen, the embattled Danish prime minister. Next week, he faces a public hearing into why he took Denmark into the war. That hearing could further dent Mr Fogh Rasmussen's popularity with an already disenchanted electorate. In one poll earlier this year, 35% of respondents said they could not think of a single admirable quality about their prime minister.

How different it was a year ago. Mr Fogh Rasmussen was being fêted for his presidency of the European Union in the second half of 2002, when he concluded negotiations on the EU's enlargement. He was applauded at home for delivering his election promises. He was riding high in the polls. Then it all changed. The press became more critical of the man whose 2001 election win ended almost a decade of Social Democratic rule. The polls now point to his defeat in the next general election, though this need not be held until November 2005. His fan-club in Europe has shrunk, and he is no longer talked of as a serious runner for the European Commission presidency.

What went wrong? To be fair, several things were outside the prime minister's control. Germany's brief plunge into recession last year led to a slowdown in the Danish economy and a spike in unemployment. The strengthening of the euro, to which the Danish kroner is pegged, is hardly Mr Fogh Rasmussen's fault. Nor was the debacle over the euro-area's stability pact, or the collapse of negotiations on a new EU constitution in December.

Mr Fogh Rasmussen has won some kudos for cutting taxes, curbing immigration, improving pensioners' welfare and cracking down on violent crime. But his government has made little progress in cutting hospital waiting-lists. His promise to foster broader left-right co-operation now seems hollow. Measures this week to cut income taxes and boost employment might deliver a temporary revival in support. But with the spectre of Iraq and terrorism now hanging over him, Mr Fogh Rasmussen's hold on his job still looks tenuous.

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Kosovo

Another eruption

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Tensions boil over again in the troubled Serbian province

“IT'S back to the old days,” lamented Daut Dauti, a Kosovo Albanian analyst. On March 18th, Belgrade's newspapers agreed. “War!” screamed one headline; “Kosovo in Blood” was another. As many as 22 people were reported dead in the Serbian province. Several hundred were injured, including a few troops from KFOR, the NATO-led peacekeeping force. NATO promptly shifted extra troops from Bosnia to Kosovo.

The Kosovo war ended in June 1999 with the withdrawal of Slobodan Milosevic's Serbian forces from this bitterly contested territory, whose population of 1.8m is 90% ethnic Albanian. Large numbers of Serbs fled or were expelled in the months that followed. Yet some 100,000 Serbs and other non-Albanians remain.

The last word on governance in Kosovo rests with the UN administration, although some powers have been devolved to a multi-ethnic government comprising Albanians and a few Serbs. The UN has been resolutely insisting that things are getting better. But progress has been extremely slow, and most remaining Serbs live either in enclaves or in the northern part that abuts Serbia proper.

This week's violence began after a Serbian youth from the village of Caglavica, near Pristina, was allegedly injured in a drive-by shooting. Three Albanian boys then drowned in the River Ibar, which divides the northern town of Mitrovica into an Albanian south and a Serbian north. The Albanians claimed that the children were chased into the river by Serbs. Rioting broke out, Serbs and Albanians began trading gunfire and Serbian enclaves elsewhere were attacked. Houses built for returning Serbian refugees were torched. Groups of angry Serbs then took to the streets in Belgrade, attacking the main mosque and burning down another in Nis.

According to Mr Dauti, the rage that has exploded in Kosovo has been building because, since 1999, “nothing has really happened.” Kosovo has not become independent, which is what the Albanians want. And its economy is dire, with unemployment as high as 70%.

In Belgrade Dusan Janjic, head of a think-tank, the Forum for Ethnic Relations, has been tipped as the new Serbian government's point-man for relations with Kosovo. He says that the renewed violence signals the “final collapse of the ideology of a multicultural society in Kosovo.” Serbia's new conservative-nationalist prime minister, Vojislav Kostunica, recently called for the official “cantonisation” of Kosovo. Albanians, probably rightly, see this as a forerunner to partition.

Both Serbian and Albanian political parties have tried to make political capital out of the week's events. But one big winner could be Tomislav Nikolic, the leader of Serbia's extreme-nationalist Radical Party. Even without the Kosovo unrest, he was set fair to become Serbia's new president in elections due to be held this spring.

The UN and the NATO powers with troops in Kosovo, which include America, had hoped that talks could begin on the final status of the province by the middle of next year. This week's violence threatens to put paid to any remaining little shoots of optimism that, until then, things could only keep getting better.

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Georgia

Saakashvili stalled

Mar 18th 2004 | MOSCOW AND TBILISI
From The Economist print edition

The unstoppable Mikhail Saakashvili stumbles over Ajaria

FIGHTING corruption, boosting pensions, racking up air miles—the new Georgian president, Mikhail Saakashvili, has seemed unstoppable since he took power in January. He briefly came to a halt this week, when he tried to enter Ajaria, a strategically vital place whose ruler, Aslan Abashidze, is a pro-Russian strongman nearly twice his age—but after a few days of confrontation, he declared that he had resolved this problem as well.

Ajaria is one of three chunks of Georgia's territory where Tbilisi's writ is weak to non-existent. So far it is the only one where bloodshed has been avoided. Now it poses a big challenge for a president who had promised to assert Georgia's sovereignty in practice as well as in theory. It is also proving a trial of Georgia's relations with a re-elected Vladimir Putin in Russia.

How did the crisis develop? Mr Saakashvili had long signalled that he would not continue the old habit of winking and nodding at Ajaria's virtual independence. Tensions have risen as Tbilisi prosecutors have begun probing money-laundering by companies linked to Mr Abashidze's relatives, many of whom hold high government posts in the region. In Ajaria, opposition activists and journalists have been attacked. After a Tbilisi reporter investigating Mr Abashidze's relatives was beaten up two weeks ago, Mr Saakashvili lost patience. “I will take control over Ajaria,” he declared. On March 14th he boldly tried to enter the region, claiming to be campaigning for parliamentary elections on March 28th. But armed supporters of Mr Abashidze blocked the border.

Mr Abashidze, who was at the time visiting Moscow, begged for help from Russian troops based in Ajaria's capital, Batumi—one of the Soviet-era military bases that Mr Saakashvili is trying to get Moscow to remove. Mr Saakashvili responded by freezing the bank accounts of the Abashidze entourage, cutting transport links (Mr Abashidze returned from Moscow only in a loop via Turkey), and putting troops and gunboats on alert. The next day he suspended banking operations in Ajaria and ordered the arrest of several of Mr Abashidze's associates.

Russia has long supported two other rebel Georgian provinces, Abkhazia and South Ossetia. These places are dominated by ethnic groups that differ from the history-conscious and assertively Christian Georgians. Ajaria shares a language and culture with the rest of Georgia, but many of its people are Muslim. Unlike the other breakaway statelets, however, Ajaria never espoused separatism, only autonomy. Russia, says Fyodor Lukyanov, editor of *Russia in Global Affairs*, a foreign-policy journal, has “no interest in creating another failed territory.” Even so, the spectre of Russian meddling gave Georgians a sickening sense of *déjà vu*.

As so often in the past, Moscow is sending mixed signals. At first the Russians accused Mr Saakashvili of trying to oust Mr Abashidze. Then they insisted that they (and their troops) would remain neutral. Moscow's mayor, Yury Luzhkov, flew to Batumi to support his “friend and brother”, Mr Abashidze. The mayor said he was acting alone; but the Russian foreign minister, Sergei Lavrov, later said that Mr Luzhkov would act as Moscow's mediator between the two sides (“It doesn't mean that someone else can't be his brother too,” he jovially reassured a Georgian journalist). Georgia's national security adviser promptly flew to Moscow.

Nobody seemed to want an armed confrontation. Despite an American military-training programme, the Georgian army is still weak, and its troops stationed in Batumi seem to back Mr Abashidze. The closure of Batumi's port, if prolonged, would harm all Georgia. The Americans were alarmed by Azerbaijan's talk of “obstacles” to the building of an American-backed oil pipeline from the Caspian to the Mediterranean, via Georgia.

On March 18th Mr Saakashvili and Mr Abashidze finally met each other, in Batumi—Mr Saakashvili's motorcade having been let across the border. A beaming Mr Saakashvili then declared that all misunderstandings were over. Mr Abashidze said there were “no issues which cannot be resolved.” But even if tensions dissipate this time, Georgia's relationship with its rebellious provinces could yet trouble Mr Saakashvili, who still has to acquire the much-needed skill of manipulating the power-brokers in Moscow.

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Russia's presidential election

Putin redux

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Seeking clues on the second Putin term

WHEN the blazing roof of the Manezh exhibition hall collapsed on March 14th, the watching crowd burst into applause. Russians love a tragedy as much as a conspiracy, and the fire at the old riding-school near the Kremlin, just after voting closed in Russia's presidential election, was both. By comparison, Vladimir Putin's re-election, with 71% of the vote, was boringly predictable.

Yet the election did spring one surprise. Nikolai Kharitonov, who stood for the Communist Party instead of its leader, Gennady Zyuganov, won nearly 14%. That is roughly what the party scored in December's parliamentary election, but three times as much as the opinion polls had predicted. Core Communist supporters, mainly older and provincial voters whose lives have improved little in four years of Mr Putin's rule, still appear loyal to the party.

Mr Putin seemed to get the message: the vote for his opponents was, he said, “essential information for the current authorities, including myself, so that we can all take account of the opinions and views of those politicians.” He spoke at length about the need for democracy, a strong civil society and press freedom, but as a sop to critics of the media bias and other tricks of his campaign. Mr Putin's democratic instincts are not well-honed: he, alone of the candidates, refused to take part in televised debates, saying “I know my opponents' every word down to the last detail.”

The next few months may offer a clearer idea about what the enigmatic Mr Putin really wants—and can deliver. Theoretically, he has more power than ever, with full control of parliament and a new government, appointed before the election, that has purged all remaining allies of the powerful “oligarchs”. Theoretically, he can steam ahead with reforms to improve the business climate, tackle corruption, slim the bureaucracy and invest in social infrastructure. When over 50 people died in Arkhangelsk this week after a horrific gas explosion, it merely confirmed that underinvestment is killing more Russians than terrorism.

Yet Kremlin-watchers debate if Mr Putin is as strong as he seems, or if he is beholden to interest groups, such as state-owned energy companies. The new government looks shaken up, with 17 ministries instead of 30, but most ministers have kept their jobs or been reshuffled; the new structure creates more agencies than it abolishes. It remains to be seen how aggressively, and how fast, the government tackles reforms.

So far the signs are of caution. This week Mr Putin broke his silence on the restructuring of the state gas monopoly, Gazprom, proposing to scrap the “ringfence” (a ban on foreigners owning domestically traded shares), create an internal gas market, and give other Russian producers access to Gazprom's pipelines. But he did not mention more radical steps, such as breaking the company into separate production and distribution parts, or scrapping the two-tier system of domestic and export gas prices that is one of the European Union's main demands before Russia can join the World Trade Organisation.

In short, Mr Putin is, for now, sticking to what he does best: balancing between the extremes. But moderation may not be enough if he is to have a real chance of transforming the economy—and the country—over the next four years.

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Charlemagne

Europe without Aznar

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Spain's new government shifts the balance in the European Union

THE bombs that altered the course of the Spanish elections have also reshaped European politics. The departure of José María Aznar and his People's Party will shift the balance of power within the European Union. Broadly speaking, this is good for France and Germany, and bad for Britain and Poland. It is good for European federalists and bad for Eurosceptics and Atlanticists. In theory, it is good for the left and bad for the right, because conservatives were beaten by Socialists. But nominally left-wing governments in Britain and Poland are mourning, and a right-wing French government is cheering. Left-right divisions are no longer the chief determinant of tribal loyalties in Europe. It is attitudes to the United States and the future of the EU that matter now.

Mr Aznar's most crucial policy choice was to embrace America's war on terrorism and the toppling of Saddam Hussein. He chose this path partly for reasons internal to Spain, notably the long struggle against the Basque terrorist group, ETA. But he also believed that Spain, as a country on the rise, could aspire to be a global power, forging new alliances in the Americas and in Europe. Under the Socialist government of Felipé González, he felt, Spain had too often passively followed a line determined by France and Germany.

Mr Aznar made little secret of his contempt for the ossified economies and leadership pretensions of the big two. He dismissed France's efforts to protect its language and film industry as a “symptom of a culture in decline”. His most recent foreign minister, Ana Palacio, loudly deplored Franco-German efforts to dominate the EU. Such attitudes caused deep offence in Paris and Berlin (Mr Aznar had famously bad relations with both Jacques Chirac and Gerhard Schröder), but secretly delighted Britain's Tony Blair.

The significance of the Aznar-inspired shift in Spanish thinking became most evident in the run-up to the Iraq war. The claim by France and Germany to speak for Europe was decisively undermined in January 2003 by the now-famous “letter of eight”, a pro-American declaration by eight European governments—Britain, Italy, Poland, Portugal, Denmark, the Czech Republic, Hungary and Spain—that was co-ordinated by Mr Aznar's people. As well as being a gesture of support for the Bush administration, it had an undeclared sub-text about the EU. Henceforth France and Germany could no longer presume that, wherever they led, the rest of the EU would naturally follow.

Spain's Socialist Party always denounced this shift away from the big European powers and towards America. They drew strength from the fact that some 90% of Spanish people opposed the Iraq war. José Luis Rodríguez Zapatero, the Socialist leader who will now become prime minister, accused the Aznar government of serving only “the interests of Bush” and of betraying Spain's traditional commitment to “pro-European” policies. He had already sworn to restore previously “magnificent” relations with France and Germany.

Now that Spain has, in essence, switched sides within a divided Europe, this could tip the European Union's fragile power balance. One EU official goes so far as to say that “with the disappearance of Aznar, the alternative pillar to France and Germany crumbles.” It certainly looks a lot weaker. Italy's Silvio Berlusconi, though pro-American, has a reputation for eccentricity and dodgy dealings that make him an alarming ally. He is also vulnerable to Spanish-style assaults from the anti-war left. Poland is a poor country, led by a weak and unstable government. The Dutch, Portuguese and Danes are not big enough to make a counterweight to the French, Germans and Spanish. Nor are the Hungarians or Czechs; some of their top diplomats have anyway long said privately that they had made a mistake in signing the “letter of eight”. The upshot may be to leave Mr Blair isolated.

From A to Z

Europe is now waiting expectantly to see how Mr Zapatero's anti-war, pro-European rhetoric translates into actual policy. Even EU officials close to Mr Zapatero's party believe that he will have to “get himself off the hook” of campaign rhetoric that strayed into isolationism and pacifism. The highest-profile issue is, obviously, his pledge to pull Spanish troops out of Iraq if a new United Nations mandate is not forthcoming by the end of June. It may be that some form of “internationalisation” of the nation-building process in Iraq will allow Mr Zapatero to soften his position. Less remarked upon, so far, has been his party's commitment to cut Spain's already nugatory level of defence spending. This would dismay not just the Americans but also many of Spain's EU (and NATO) partners.

European leaders will get a chance to assess Mr Zapatero at their summit in Brussels next week. This meeting had been expected to concentrate on economic reforms (the so-called “Lisbon” agenda, which Mr Aznar played a key role in devising), but it will now be overshadowed by terrorism and security issues. There have been calls for a European CIA, reflecting the instinct of federalists that, whatever the problem, “more Europe” is always the solution.

More significant may be confirmation that Mr Zapatero's arrival will make it a lot easier to agree the new EU constitution. It was largely Spanish and Polish objections to a new voting system—the “double majority”—that scuppered efforts to strike a deal at December's EU summit. But Mr Zapatero has signalled that he will accept double majority, raising the prospect that the isolated Poles may have to fold. In fact, this concession was one that the Aznar government had already hinted at. But the new Spanish government may influence the constitution in other ways. The Socialists favour pan-European tax harmonisation, for instance; one more reason for Mr Blair and the British to regret the passing of José María Aznar.

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The budget

The gambler

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AP

The chancellor was right, and most observers were wrong, about economic growth. He's gambling that the same is true of the public finances

Get article background

GORDON BROWN'S eighth budget was about politics, not economics. Given how fast the budget deficit has been growing, a prudent custodian of the public finances would be raising taxes or cutting spending. But, with an election likely next year, neither was uppermost in Mr Brown's mind. Instead, he kept his budget neutral, stayed rather quiet about the state of the public finances and had a great deal to say about the economy.

The economy is Labour's biggest electoral asset. Mr Brown made the most of it, and of the fact that his prediction for the economy in 2003, which many thought over-optimistic, turned out to be spot on. The Treasury now expects above-trend growth in 2004 and 2005.

Clearly there are risks to this forecast—especially that higher interest rates will prick Britain's housing bubble. The record trade gap in January was an uncomfortable reminder that the economy remains unbalanced, with the recovery driven by domestic demand rather than exports. For the time being, though, Mr Brown's record of economic stability remains intact.

But if the economy is strong, the public finances are not. Four years ago, at a similar point in the electoral cycle, Mr Brown's fiscal position was impregnable, with a surplus of £15 billion ($27 billion). Now he has a deficit of £38 billion—3.4% of GDP. He is forecasting deficits of £33 billion in 2004-05 and £31 billion the year after.

On the face of it, deficits on this scale argue for tax increases or spending cuts, but Mr Brown maintains that much of the deficit is cyclical, not structural. If he is wrong, he should be tightening fiscal policy now. Failing to do so will mean more pain later.

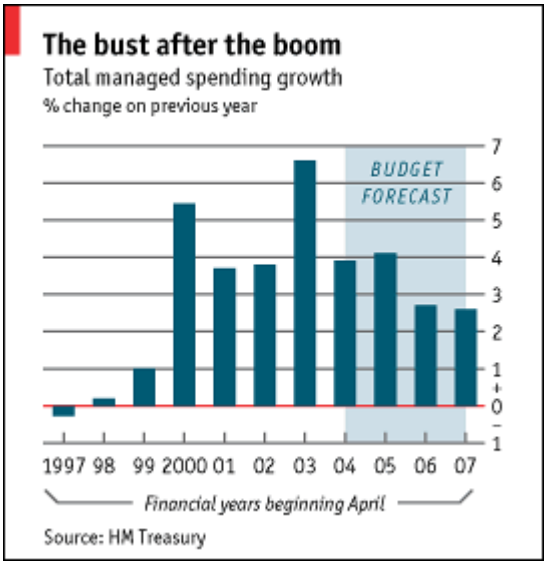
Mr Brown's main fiscal rule is to balance the current budget (which excludes investment) over the cycle, which runs from 1999 to 2005 according to the Treasury. The chancellor claims that he will still meet this “golden” rule—although his comfort room has shrunk over the past year. However, John Hawksworth, economist at PWC, an accountancy firm, forecasts that he will narrowly miss it.

The Treasury's optimism on the current budget is based on a rosy outlook for tax revenues. Without explicit tax-raising measures, it is forecasting a rise in the tax take from 37.8% of GDP in 2003-04 to 39.9% in 2006-07. This increase, worth over £20 billion in today's money, seems implausible even allowing for a likely cyclical recovery in tax revenues. Mr Hawksworth is particularly dubious about the Treasury's forecasts for corporation-tax receipts.

Others are sceptical, too. In January, the OECD said that “although the golden rule would just be met in the current cycle, a sizeable structural deficit would persist”. Such warnings allow the Conservatives to talk of Labour's “third-term tax rises”. Replying to the chancellor's speech, Michael Howard, their leader, labelled Mr Brown the “borrow now, tax later chancellor”.

Mr Brown, for his part, taunted the Conservatives about their plans to avoid tax increases by cutting departmental budgets outside health and education. Yet the centrepiece of his budget was a sharp slowdown in spending growth in two years' time (see chart).

The squeeze on most departmental budgets will be intense, since the National Health Service will continue to get increases of over 7% a year until 2007-08. Mr Brown revealed that education will get a relatively generous settlement, but other ministers will get slimmer pickings. According to Mr Hawksworth, the remaining departments, including defence, transport and the Home Office, will be scrabbling over meagre increases in their budgets of around 1% a year.



No wonder Mr Brown has embraced the cause of greater government efficiency with such zeal. Last year, the chancellor asked Sir Peter Gershon, head of the Office of Government Commerce, to investigate the scope for economies from new technology and changes in working practices. The chancellor said in his budget speech that Sir Peter's report will unveil potential savings of £20 billion a year by 2008, and anticipated it by announcing thousands of civil service job cuts, including 30,000 from the Department of Work and Pensions alone—a quarter of its workforce.

Civil-service unions, which were taken by surprise by the announcement, are horrified. But for Mr Brown, plans for cutting jobs seem not only to give him more fiscal room, but also help to skewer the Conservatives, who recently unveiled spending plans heavily dependent on cutting back a public sector workforce that has been expanding fast under Labour.

At the last election in 2001, the economy had been booming, the Treasury's coffers were overflowing and the government could pledge handsome increases in public spending. Come the next election, Labour will be able to capitalise again on a robust economy. But Mr Brown's budget reveals that the government will be on much shakier ground on the public finances and spending. That will make for a more even contest.

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Mind that comma

Mar 18th 2004
From The Economist print edition

Reuters

Posters plastered over the London Underground after the Madrid bombings seemed oddly keen to encourage natural British reticence rather than vigilance. They may, of course, have been planted by punctuation zealots to illustrate to the grammatically lazy the importance of using commas and semi-colons correctly.

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Housing

Brown's fields

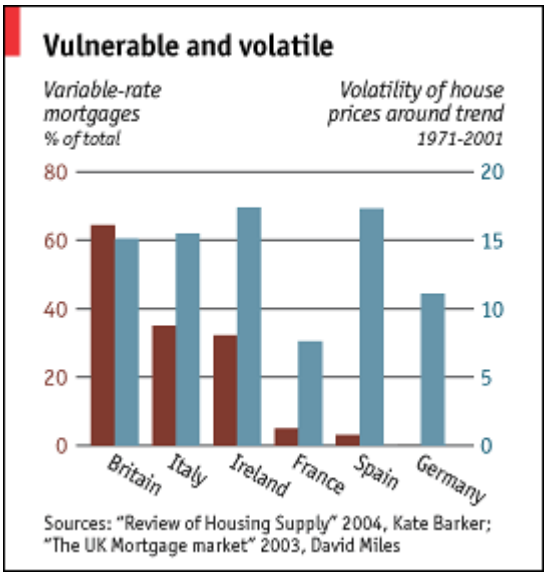
Mar 18th 2004
From The Economist print edition

Concrete is coming to a building site near you

AFTER a moment of macroeconomic self-congratulation early in his budget speech, Gordon Brown turned to the bit of the economy that is not behaving as it should: housing. In the past week two experts have presented him with studies of it and advice on how to fix it.

Both studies were commissioned last year in a bid to gauge whether Britain's housing market makes its economy too jittery to join the euro area. But the government is also worried about the housing market for two domestic reasons—that a crash could cause a wider recession, and that property is too expensive.

Britain's reliance on variable-rate mortgages (see chart) makes the entire economy too sensitive to changes in interest rates. David Miles, an economist at Imperial College, London, was asked to recommend how borrowers could be steered to less-risky fixed-rate mortgages.



Some had expected Mr Miles to recommend market-distorting tax-incentives for fixed mortgages, or the creation of a government-sponsored mortgage underwriter along the lines of America's Fannie Mae, which would put taxpayers' money at risk. But he has gone for neither of these. Instead, he wants lenders to offer their entire range of products to all customers.

At present, lenders offer cheap rates to tempt new customers, so borrowers who shop around get better deals than those who stick with their existing mortgages. Mr Miles calls this "cross-subsidisation". He wants to force lenders to offer their entire range of mortgages to all customers, which will limit "cross-subsidisation", which in turn will limit the discounts offered on variable rate mortgages, which in turn will make fixed-rate mortgages, by comparison, look more attractive.

Critics worry that, although such a rule might be good for economic stability, it might also make mortgages more expensive, since lenders might simply end their cheap deals. Many would prefer the government to pursue Mr Miles's requests to loosen rules that restrict banks from hedging the risks of fixed mortgages and block the creation of a market for mortgage bonds. Liberalisation would make it easier for banks to offer fixed-rate products when and if borrowers want them.

Such mortgage minutiae are central to the vulnerability and volatility of the housing market. But it is the Barker report on housing supply that is more likely to send a shudder through middle England.

The government commissioned Kate Barker, a member of the Bank of England's Monetary Policy Committee, to look at supply principally because it is worried about public-service workers in the southeast, such as teachers and nurses, whose ranks Mr Brown aims to increase. They are finding property less and less affordable: 45% of first-time buyers today, according to Professor Miles, take out a mortgage that is more than three times their annual income, up from 10% in 1993.

Some 175,000 houses are built each year. Ms Barker thinks that an additional 70,000 houses need to be built in order to bring real price growth down to 1.8% a year from the current 2.4%. More ominously, she says that some 120,000 additional houses per year are needed to reduce real price growth to 1.1%,

which would be closer to European averages.

Not everybody agrees that more concrete is needed. Some point out that, although house prices are historically high, average monthly mortgage payments are not. True, London prices have risen faster than those elsewhere, making life hard for public-sector workers in the capital; but that problem would be solved more easily by paying them more than by trying to manipulate the housing market.

Others argue that the house-price rises in the south-east are necessary. They help to redistribute growth around the country. Measures to keep down prices in the south-east will diminish the tendency for growth to spin out from the south-east.

In a report for the Campaign to Protect Rural England, Andrew Lilico of Europe Economics argues that the housing crisis is a myth stemming from population overestimates in 2000. The 2001 census found there were half a million fewer households than previously thought. He says the new figures mean there are more dwellings than households in every region.

A bill is already going through Parliament to shift planning powers from county councils towards regional development authorities, which are not elected and so are likelier to favour development. Ms Barker recommends a further loosening of the planning regime. But it will take a lot of concrete to shift prices, since, at present, new construction represents only around 1% of the total housing stock.

The home counties will not like it. The government will find it easier to plump for Ms Barker's less controversial recommendations, such as a windfall profits tax on land developers, encouraging greater competition among housebuilders and dealing with the skills shortage in construction.

Ms Barker also thinks up to £1.6 billion needs to be spent on “social” housing. This conjures up a vision of the 1960s, when many of the ugliest council estates, which did huge social damage, were built.

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Tax avoidance

No avoiding Mr Brown

Mar 18th 2004
From The Economist print edition

A broad new rule will wallop the tax-avoidance industry, Mr Brown hopes

GORDON BROWN has not just a chancellor's but also a puritan's hatred of tax avoidance. That shows in this year's budget, which includes the broadest swipe ever taken at Britain's huge tax-avoidance business: a general requirement that tax advisers register their avoidance schemes with the Inland Revenue soon after selling them to clients.

Time was when the law accepted that the citizen, so long as he stayed within its wording, could so arrange his affairs as to save every possible penny of tax. But in 1981 the House of Lords ruled that, if the purpose of a step in some scheme was solely to avoid tax, the taxmen could ignore it, as if it had never happened. However, the Lords themselves have shrunk from ruthlessly applying their own rule. Now Mr Brown hopes his new plan will let the taxman apply it ruthlessly.

At present, to overturn a scheme, the Inland Revenue must first find out about it—and tax advisers hardly shout their latest ploys from the rooftops. Then they must challenge it, when the user's tax return comes in. Then they may have to fight a case through an appeal within the Revenue machinery. Then they may have to go to court.

The new plan, based on American law, will cut all this short. Advisers—and their clients—will have to reveal all, almost from the start. Long-delayed, after-the-event, hair-splitting arguments about conformity with the letter of tax law will be replaced by a simple question from the Inland Revenue: did you tell us or did you not? And if you did not, there are penalties.

Mr Brown has not gone as far as Australia has. Its taxmen have a general right to rule out any avoidance scheme that they deem to be such. Nor, in theory, has Mr Brown gone quite as far as America has. There, advisers have to tell all even before a scheme is sold. That is what British advisers feared after the Treasury summoned the four biggest accounting firms to give them a wigging last week.

But it makes little difference whether the Revenue must be told before or after a scheme is sold. The effect, says one firm, will be the same. The taxmen will not be able to refuse to register a scheme, but they will know all its details, and can in effect ban it overnight by announcing that retroactive legislation will be coming later. In those conditions, the only schemes that will be saleable are those which the Inland Revenue clears.

The Treasury and the tax practitioners still have to settle the question of what amounts to a disclosable tax avoidance scheme. A plan set out in black-and-white and sold to a dozen clients clearly is. But what if an adviser is just discussing with some company how best to organise its finance? Or a scheme to shift profits from one foreign country to another? That is indeed their concern, but is it Mr Brown's?

It may not be yet; but that may not last. On budget day Britain's taxmen revealed that they and those of Australia, Canada and America are to share experience and expertise on “abusive tax transactions”. Interfisc looms.

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Public sculpture

No arm in it

Mar 18th 2004
From The Economist print edition

A sculpture chosen for Trafalgar Square is not as radical as seems

PLANNING decisions are notoriously slow, but the one that has just been taken about what to put on the empty plinth in London's Trafalgar Square may be a record. Aside from a few temporary exhibits, the plinth has been empty for 163 years. It was built for a statue of King William IV that was never cast because the money ran out; ever since it has brought joy to newspaper columnists short of inspiration and to radio phone-in producers with a slack hour to fill. Traditionalists have spluttered with outrage at radical suggestions such as a car covered with pigeon-droppings; trendies gag at the fogeys' campaign to stick the Queen Mother up there.

With Ken Livingstone as mayor of London, the traditionalists did not stand a chance. A man keen to keep his radical credentials polished, the mayor appointed a committee to decide what to put on the plinth. On March 15th, it announced its choice: “Alison Lapper Pregnant”, a sculpture of a naked, pregnant, disabled woman, will occupy the space for 15 months.

The sculptor, Marc Quinn, is a fashionable protégé of Charles Saatchi, a London art collector; he is best-known for a self-portrait in his own, frozen, blood. His piece for the plinth mimics classical sculpture, thus implicitly criticising the image of bodily perfection purveyed by traditionalists.

But Trafalgar Square is a difficult place to argue that disabled people have been ignored by mainstream sculpture. Ms Lapper will be looking up to the most famous cripple in British history, the one-eyed, one-armed victor of the Battle of Trafalgar, Horatio Nelson. Last laugh to the traditionalists, then.

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Drinking culture

In a pickle

Mar 18th 2004
From The Economist print edition

Britons drink southern European quantities in northern European style

HOW do you turn a nation of sots into responsible drinkers? Five years ago, the answer seemed obvious: sweep away the archaic licensing laws, which encouraged rapid “drinking up” and filled the streets with legless punters at eleven o'clock. Once liberated from the tyranny of last orders, it was thought, people would calm down and grow up. A childish, candy-store attitude to alcohol would gradually lose out to continental hauteur.

The northern European norm

That convivial notion led to the relaxation of licensing codes and then to the Licensing Act, which comes into force this year. But police and politicians are already starting to get a morning-after feeling. This week, the prime minister's Strategy Unit acknowledged a growing drinking problem that costs the nation £20 billion a year, and outlined some stern measures to discipline drunks and the pubs that serve them. It looked very much like the beginning of a 12-step programme.

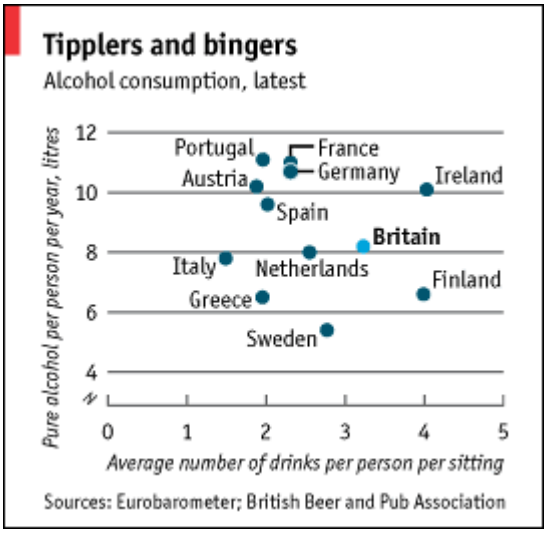
The nation has not always craved alcohol. In 1970, the average Briton drank the equivalent of 5.3 litres of pure ethanol per year—less than a third as much as the French or the Italians. In common with other sunless nations, a certain amount of bingeing went on. But a puritanical tax regime, combined with unusually firm licensing, kept the stopper in the bottle.

Over the past few years, though, more money and looser licensing have enabled Britons to combine the drinking habits of northern Europe with the consumption levels of the south. In terms of ethanol downed, they have overhauled the Italians and are gaining on the French and Spanish. But they still haven't learned to drink in moderation. Women have clung to Scandinavian notions of egalitarianism by getting just as smashed as men.

Evidence from other northern European countries suggests that habits will be hard to change. Decades of heroic taxation and strict control over sales have persuaded Scandinavians to give up on regular spirit-fuelled benders. Now, though, they simply wait for the weekend to get drunk on beer. According to Robin Room, of Stockholm University's Centre for Social Research on Alcohol and Drugs, “There are norms about how much you should drink in social situations, and these don't change much. What changes is how often people do it.”

The other thing that has changed is where they do it. Britons, unlike other northerners, like to go out to drink. They used to favour places that looked much like their living rooms, but, thanks in part to local regeneration schemes, these have lost out to high street bars. That is another nod to Mediterranean culture, except for the level of disorder they attract. Victim surveys show that roughly four in ten assaults now involve drinkers, and more than half of these take place on Friday and Saturday nights. Some provincial city centres have become no-go areas for the over-30s.

Those who try to modernise British drinking habits should perhaps not be surprised by these hitches. As the former rulers of this troublesome isle could have told them, it isn't easy to turn barbarians into Romans.



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Wind power

Tilting at windmills

Mar 18th 2004 | GREAT GLEMHAM, SUFFOLK
From The Economist print edition

Wind power was expected to flourish offshore. So why is it mostly onshore?

THE hedgerows of Great Glemham, a small village in Suffolk, make an unusual billboard for political posters. Currently they feature eye-catching protests against plans for a wind farm on a disused airfield in next-door Parham. When the project was announced in December, residents mostly welcomed the idea. Many have now changed their mind and relations with the farmer who owns the site, an upstanding member of the Parish Council, have become strained. In the middle of one Saturday night, someone snuck around taking all the posters down.

When subsidies for wind energy were first mooted, most wind farms were expected to be built offshore, since there is a lot of wind there and seagulls don't sit on planning committees. But the subsidy system, under which wind farms sell renewable obligation certificates (ROCs) to conventional generators, rewards onshore and offshore farms equally, and building on land is less risky or costly than building at sea, where special barges costing £30m each are needed to manoeuvre the turbines into position. Developers therefore favour onshore projects, and farmers, driven by falling agricultural incomes to look for new sources of income, are happy to oblige. Of 22 wind farms due to be built this year, 21 are onshore.

Wind farms get around three times as much in subsidy—a mixture of selling ROCs and a share of fines paid by non-renewable plants—as they do from selling electricity. Powergen reckons that putting up just two or three turbines becomes viable on this model. Other investors are picking up on this too: Saxon Windpower, the company that wants to put up six turbines on Parham airfield, is backed by a venture capital fund based in the Bahamas. Small wind farms are therefore proliferating.

The hostility aroused by the Parham project is not unusual either. Some locals complain that wind farms are noisy, ugly and (citing estate agents) that they reduce property prices. Others, like John Constable, who lives 700 metres away from the airfield, say they are just inappropriate. “I happen to like the Chrysler building,” he says, “but I don't want it near my house.”

The British Wind Energy Association says around half of all planning applications in England get scuppered (mostly by angry local residents), though the success rate is higher in Scotland and Northern Ireland. Locals have some control, but not as much as they would like: district councils decide on applications for wind farms with a capacity of under 50MW (around 25 turbines), while bigger proposals go to central government.

Wind farms' opponents argue that a carbon tax would be a better way of discouraging pollution than subsidising particular forms of renewable energy—and that, among green energy sources, wind is one of the least efficient. Hugh Sharman, author of several studies of wind power in west Denmark, which has the highest concentration of turbines anywhere in the world, points out that in February last year the wind stopped blowing and almost no power was generated. When this happens electricity has to be imported from elsewhere or generated by conventional plants kept as back-up. This isn't very green:

keeping thermal power stations ticking over consumes energy without producing any useful power, and cranking them up and down is inefficient and dirty.

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University exams

Grade expectations

Mar 18th 2004
From The Economist print edition

Universities are handing out more first-class degrees than ever. Why?

FIRST-CLASS degrees used to be awarded very sparingly. According to one Cambridge joke, examiners in moral sciences (philosophy) used to shun awarding firsts, because that would imply that the candidate was as clever as the examiner, which would be logically absurd.

That's changed. New statistics this week showed that the number of firsts awarded by Britain's 19 top universities had risen by half in the past five years. In 1998 they gave 6,314; last year it was 9,475. This caused much harrumphing about dumbing down. It follows similar howls about mushrooming top grades in schools.

There are some innocent explanations. Numbers have risen (although not nearly enough to account for the improvement). Students may be better: perhaps working a bit harder, or with teaching more focused on the all-important exam, rather than on woolly stuff like thinking and ideas.

More likely, though, the drift towards firsts reflects more worrying problems. Marking finals at top universities used to be prestigious, well paid and solidly protected from outside pressure. That ensured hard, careful work by senior dons. Now examining is seen as drudgery, best farmed out to junior staff.

Dons also complain that increasing government scrutiny means they are under pressure not to fail students or give poor grades. That would suggest that they had failed to select and teach students properly. It is wiser to be kind.

Another factor is plagiarism of coursework that counts towards a degree. Universities are finding this an increasing problem. Internet websites offer ready-made essays. Some universities use software to catch cheats. But the trend is away from punishment—meaning that the incentive to plagiarise is growing.

So Britain may be going down the same path as America, where all students, wags say, expect to be above-average. Research by Stuart Rojstaczer of Duke University says that GPA (Grade Point Average) scores have been increasing steadily since the 1960s, with a noticeably higher rate of inflation at private universities, which compete hardest for pupils.

That is ominous news, given the government's intention of moving towards a similar customer-based model of higher education. In theory, a university should benefit in the long run by being stingy in awarding firsts, and thus maintaining a reputation for quality. But the evidence from America doesn't support that: Harvard, for example, is notorious for awarding fully half its students As or A-minuses. Larry Summers, the university's president, says the system lacks integrity, but people were furious when he tried to change it.

The economics of generous marking are straightforward. When the many who are merely good get the same top grades as the few who are truly brilliant, there are more winners than losers; marking more toughly creates the opposite. If universities admit the problem at all, the most they are likely to do is introduce new top grades. This week Mr Summers called for a new A-plus and an A-double-plus at Harvard.

Does any of this matter? Few employers regard the class of degree as more important than the subject studied, or the university attended. Exams give only a partial picture of a student's talents; it is right not to take them too seriously.

If firsts are awarded rather more freely, the incentive to work really hard may be dented a little, but not

much. Most people will still swot hard to get top marks. The truly brainy will probably be studying for the love of it, rather than because of the marks. Which is as it should be.

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Bagehot

The shadow over Tony Blair

Mar 18th 2004
From The Economist print edition

The Madrid bombings have shaken British politics

THE juxtaposition could hardly be sharper. On one side, a prosperous, stable economy and a chancellor brimming with confidence and certainty. On the other, profound insecurity, a growing sense of dread and a prime minister full of foreboding about a threat both “real and existential”.

In normal times, a budget intended to set the agenda for the next election would be a political event of the greatest importance. Gordon Brown's long stint at the Treasury has not been without fault, nor has he made the economy quite as immune from future shocks as he boasted when delivering his budget on March 17th. He also continues to be a good deal more optimistic about future tax revenues and a virtuous rebalancing of the economy away from consumption than most commentators are. But for all that, Mr Brown's success is the most solid achievement to which the government can lay claim. He has delivered growth that has not only been uninterrupted over the course of two parliaments, but has also been at a higher rate than in other big European countries. The question of whether he did that by luck or design is unlikely to trouble most voters.

He has also achieved something matched by no other Labour chancellor: the funding of a large and sustained increase in spending without triggering a crisis in the public finances. Again, he can be criticised for the way he has gone about things, in particular his stubborn determination to pour huge sums of money into the sickly, capacity-constrained health service before the patient could fully absorb the medicine. But despite the waste and the scepticism it has bred, there is mounting evidence that the public services people care about most are slowly improving. And finally, Mr Brown has been a stealthy but effective champion of the poor.

The chancellor's huge self-satisfaction may not be entirely attractive, but it is understandable. He believes he has established an economic platform from which it is almost unthinkable that Labour will lose the next election. But these are not normal times and, after the appalling events in Spain, thinking the hitherto unthinkable suddenly seems quite a reasonable thing to do.

Ministers have, of course, been quick to explain why the bombings and the electoral earthquake which followed have changed nothing here. A few people may be less inclined than before to scoff at Tony Blair's apocalyptic warnings, repeated only a fortnight ago in a passionate defence by the prime minister of his policy on global terrorism. Far from being tormented by demons of his own imagining, as some had jeered, Mr Blair has been vindicated, albeit in a ghastly way.

Many Spanish voters seem to have concluded that the decision to go to war in Iraq had made America's coalition partners more vulnerable to attack. This, say ministers, misses the point. The September 11th hijackers didn't need the Iraq war as a pretext. Besides, Britain, because of what it represents, has always been near the top of the al-Qaeda target list. No country, least of all Britain, can opt out of the war on terror. Nobody is under any illusion: no matter how much luck and skill you might have in combating the terrorists, something terrible is bound to happen at some stage.

And if the worst does occur, say in London, the political fall-out will be less dramatic here. After all, the main opposition party unequivocally supported the war and still does. Britons were far less hostile to the war than were the Spanish: Britain remains fairly evenly divided over it, while in Spain over 90% thought it wrong. Anyway, ministers protest, the Spanish government made the fatal mistake of trying to gain political advantage from a terrorist outrage by pinning it on the wrong set of murderers: this government would never do that.

Like much else said about the war on terror, this is only partly convincing. In the first place, although

there were strong arguments for the war in Iraq, among the weakest were those that claimed it was integral to the war on terror. Mr Blair deserves credit for being one of the first political leaders to understand how the world was changed by September 11th, and this newspaper thinks he was right to support America in getting rid of Saddam Hussein. But many people who are serious about fighting al-Qaeda quite reasonably ask whether invading Iraq helped or hindered that effort. Mr Blair's insistence on conflating the two does not help him.

Bombs and ballots

Britain was indeed under threat before the bombs in Spain, but those bombs may well have increased the threat. The terrorists have seen how effectively their bombs can leverage unhappiness over the war. Mr Blair can't say it, but he knows that the response of Spanish voters and their new prime minister, José Luis Rodríguez Zapatero, to the assault on their society has made hitting Britain even more tempting to al-Qaeda.

Despite the official line, the possibility of a major terrorist spectacular during the election campaign is now being taken very seriously (although the lack of a fixed election date will hinder the terrorists' planning). But nobody can gauge what the political impact of such an attack would be. A poll carried out this week by YouGov for Sky News found that 75% believed that Britain's role in the Iraq war had made the country more vulnerable. However, with no plausible beneficiary of the voters' anger except the anti-war Liberal Democrats, the outcome of the election might well be unaffected.

But what of Mr Blair? People believe, rightly, that Iraq was Mr Blair's war. Without his fervour and conviction, Britain might not have fought. If the bombs go off, how will they judge Mr Blair? It is difficult to imagine more terrible circumstances for Mr Brown finally to achieve his life's ambition. But after the past week, it is far from unthinkable.

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Behind the mask

Mar 18th 2004
From The Economist print edition

ImagineChina

Hailed as the business opportunity of the century, China is bound to disappoint. Sameena Ahmad (interviewed here) examines the mismatch between excitable perception and sober reality

THE whole world's gaze is fixed on China—not just because the country is vast and growing rapidly, but because it profoundly affects the fortunes of companies everywhere. Around the globe, shelves are stacked with the low-cost goods churned out by “the world's workshop”. Chinese-based manufacturers suck in imports and dictate global prices of everything from steel to microchips. For foreign companies, a huge market beckons as China liberalises its relations with the rest of the world, having acceded to the World Trade Organisation in 2001.

China's progress since it first opened to foreign investment and reform in 1978 has been dazzling. Over the past 25 years, its real gross domestic product has expanded at an average of 9% a year. Growth in foreign trade has averaged 15% annually since 1978; China's trade surplus with America is now twice the size of Japan's. And every week, more than $1 billion of foreign direct investment flows into the country. All this testifies to the global integration of China's economy, now the sixth-largest in the world with a GDP of $1.4 trillion.

This rapid growth has ensured political stability. Whereas socialist regimes around the world have crumbled, China's Communist Party survived the 1989 Tiananmen Square uprising, the 1997 Asian crisis and last year's SARS virus without making concessions to democracy. The present leadership is well-educated, capable and pragmatic.

Internationally, China has become respectable, more a partner than a threat. The continuing debate about the “undervalued” yuan says more about partisan American politics than about Chinese mercantilism. Domestically, the government is well aware that its political acceptance derives solely from rapid economic growth, and will do whatever is necessary to meet its internal benchmark, an annual rise of 7%. China's leaders still call themselves communists, but they have become capitalists in practice. If they have a guiding philosophy, it owes nothing to Mao or Marx, but is best summed up by Deng Xiaoping's famous dictum: “It doesn't matter whether the cat is black or white, as long as it catches the mouse.”

The combination of growth, stability and potential has set off a tidal wave of foreign enthusiasm for

China. Businessmen return from pilgrimages to Shanghai and Beijing convinced that this is China's century. Robert Bestani, head of the private-sector arm of the Asian Development Bank, calls the phenomenon “future shock”—change so rapid that it seems like a vision of the future. Dietmar Nissen, East Asia president of BASF, a huge chemical company, says that “the speed and scale of growth in China over the past 12 years is a miracle. It is a miracle that China is developing in such an orderly fashion.” Messianic terms are *de rigueur* when discussing the country's 1.3 billion consumers, its vast pool of low-cost workers and its need for every imaginable product and service. Goldman Sachs, an investment bank, predicts that by 2040 China will overtake America as the world's biggest economy.

This survey will cut through some of the hyperbole currently enveloping China. Progress there is as real as it is dramatic, but the country is still in transition from one political and economic system to another. The constraints imposed by the communist leaders (not least on themselves) have produced “a darker reality” behind the impressive statistics and soaring skylines, in the words of Orville Schell, a professor at Berkeley who knows the country well.

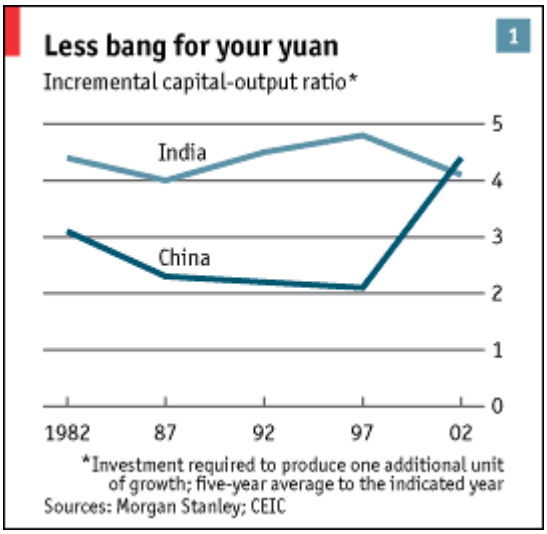
Look on the dark side

China needs 12m-15m new jobs every year just to keep pace with its population growth. It has to provide opportunities for the 800m people living in rural areas who have been left behind by the current boom, and a third of whom are under- or unemployed. It also has to deal with the 100m-150m migrant workers in the cities who have no job security, no long-term housing and no health care. And it needs a functioning pension system. No wonder the government is concerned, above all, with growth and job creation.

Currently there are worries that the economy is overheating. Bubbles are beginning to form in property, steel and cars, and power generation is running up against capacity constraints. China's real problem, however, is not inflation but overinvestment. In its quest for growth, the government has directed its

state-owned banks to open the taps. Easy credit is producing massive overcapacity, leading to deflation, more bad debts and fewer new jobs. Already, nine-tenths of manufactured goods are in oversupply, yet investment in fixed assets last year grew by 30% and contributed 47% of GDP. Three-quarters of China's growth comes from capital accumulation, according to Paul Heytens and Harm Zebregs of the IMF, yet total factor productivity—a measure of overall economic efficiency—rose by only 2% a year in 1995-99.

Even for a developing economy, China's level of investment is unusually high. South Korea in its period of rapid growth in the 1970s and 80s had investment levels closer to 25% of GDP. But the biggest concern is that China's growth is staggeringly wasteful. Whereas in the 1980s and 90s it took $2-3 of new investment to produce $1 of additional growth, now it needs more than $4. Even India, often compared unfavourably with China, is now more efficient on that measure (see chart 1).



Only a very high domestic savings rate—around 40% of household income—and the uncontrolled exploitation of its natural resources make it possible for China to waste capital on this scale. But neither is sustainable. With little social welfare on offer from the state, the Chinese need to save to provide for themselves. And environmental degradation and noxious pollution are storing up costs for the future. All this means that China's growth will have to slow markedly unless its government wants to drown in debt—maybe not this year or next, but soon.

That is yet another risk for businesses already facing a host of challenges. China's developing capitalism is not solidly based on law, respect for property rights and free markets. It is unbalanced and potentially unstable. Multinational companies operating in China have often failed to produce an adequate return on their investment, or indeed a profit of any sort. That is partly their own fault, because they overestimated the market and underestimated the competition. With experience, more are getting it right. However, the business climate in China remains capricious and often corrupt.

Chinese firms contribute to that climate. State-owned enterprises are much more concerned to maintain patronage and employment than to generate profits, and even the best are not globally competitive. China's fledgling private businesses, by contrast, have shown astounding growth and produced the country's first crop of wealthy entrepreneurs. But they are still too small to offer an effective counterweight to the state sector.

It is in the financial sector that China's brand of “not wholly black, not fully white” capitalism works least well. The banks do not allocate capital rationally, and they are vulnerable to external shocks. Yet the potentially huge cost of reforming them will constrain the government's ability to finance economic growth. That will have implications for China's political stability, and for its attractiveness as a place in which to do business.

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A billion three, but not for me

Mar 18th 2004
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The prospect of a vast domestic market of 1.3 billion consumers has lured countless companies to China

Reuters

The wrong kind of plastic

OUTSIDERS have dreamed of China's riches for 700 years. Marco Polo was awed by its scale in the 13th century. Two hundred years later, Christopher Columbus annotated his copy of the Venetian adventurer's "Travels" with the words "*Mercacciones innumeras*" ("an incalculable amount of trade") before setting out for mythical Cathay. British merchants in the 19th century hoped that selling opium and silver in exchange for silk and tea would give them access to the huge country. But it has been with the rise of globalisation, as Joe Studwell writes in his book, "The China Dream", that "the belief in China's unparalleled potential has taken on the order of an obsession."

So far, China has always disappointed. Marco Polo came home with little more than his memories, and Columbus never reached it at all. When George III's ambassador, Lord Macartney, headed a 700-strong trade mission to China in 1793 to sell advanced western telescopes, barometers and airguns, Emperor Qian Long told him that China had not "the slightest need of your manufactures".

And so it has proved. A British writer observed in the 1840s that "if we could only persuade every person in China to lengthen his shirt-tail by a foot, we could keep the mills of Lancashire working round the clock." But the length of Chinese shirt-tails remained the same. Carl Crow, an American who marketed pharmaceuticals for foreign firms in Shanghai between the two world wars, wrote in his 1937 book "400 Million Customers": "No matter what you may be selling, your business in China should be enormous, if the Chinese who should buy your goods would only do so." They never did. Astonishingly, in his 25 years there, Crow's agency failed to launch a single successful product.

This time it will be different, or at least that is the hope of the current generation of businessmen and politicians streaming in and out of China on trade missions and corporate visits. Patricia Hewitt, Britain's trade secretary, ended a trip to the country in January with an exhortation to British businesses that echoes Crow and Columbus: "What is staggering about China is its size, its scale, the enormity of the numbers, the scale of the opportunities. Even a very small part of this very large action will be good for Britain."

But as in imperial times, the country's scale can prove more of a hurdle than an opportunity. China has 31 provinces, 656 cities, 48,000 districts, seven major dialects and 80 spoken tongues. Climate and geography vary from the freezing northern plateaus to the semi-tropical south. There are enormous disparities in income, education and lifestyle between city dwellers and farmers, and between the wealthy east coast and the poor west and north-east. For most products, there is no such thing as a national market. China's consumers are too dispersed, too inaccessible and too different from each other.

Underdeveloped transport, lack of sophisticated logistics and the need for countless middlemen mean that foreign firms struggle to set up regional distribution networks, let alone national ones. Efficiency is a distant dream. B&Q, Britain's largest DIY retailer, has 600 vendors supplying its 350 British stores, but 1,800 for its 15 Chinese ones. Yet as Tex Gunning, president of Unilever Bestfoods Asia, says: "Foreigners still think they can tackle China in one go, when they would never start in 17 countries in Europe at once."

True, even a single regional or urban market in China represents a big opportunity, particularly given the

country's rapid growth. That combination lured more than $300 billion of foreign capital to China in the 1990s and $50 billion last year alone. But anything can grow rapidly from a low base, and in China almost everything is starting from next to nothing. Car sales, for instance, soared by 75% last year. But then China has only 15 cars per 1,000 people, compared with America's 700.

That elusive middle class

So what is the real size of the Chinese market? At the end of 2002, the date of the most recent official estimate, China had a population of 1.28 billion, of which two-fifths (502m) lived in urban areas and the rest in rural ones, and which was growing at 0.65% a year. Average disposable income per person was 4,520 yuan ($545), nowhere near the $5,000 level at which economists say discretionary spending takes off, and little more than 2% of America's $25,000-plus. Measured by GDP per person, which breached $1,000 in 2003, China is only half-way to becoming a middle-income country as measured by the World Bank, ranking below places such as Namibia, Guatemala and Morocco.

Rural households, with disposable income of 2,620 yuan per person in 2003, still spend nearly half their money on food and less than 15% on culture, education or recreation. Urban dwellers are better off, with disposable incomes of 8,500 yuan per person, but even the top 20% of this group—numbering 100m—earn on average just 15,380 yuan, which at less than $2,000 is still well shy of that $5,000 threshold. Undoubtedly there are rich people in China, people who can afford villas, limousines and foreign holidays. But they are a tiny minority.

To be sure, urban incomes have been rising by an astounding average of 14% a year since liberalisation in 1978. But they would have to keep growing at that rate for another 13 years to reach the magic $5,000. Most Chinese simply do not have spare money to spend, and won't have for many years—if only because they are so worried about the future that they are saving a large proportion of their meagre incomes. Before market reforms, they earned very little but enjoyed a measure of security of food, housing and employment under the “iron rice bowl” system. Now they themselves have to make provision for unemployment, sickness and retirement.

According to Andy Xie, chief Asian economist at Morgan Stanley, a bank, the Chinese have accumulated household wealth equal to 140% of GDP over the past two decades, largely in bank deposits and property. But experience in richer countries shows that populations do not stop saving until they reach 300-400% of GDP, and Mr Xie hazards a guess that because of rising life expectancy, one-child families and an early retirement age, China will stabilise at the high end of that range. All this means it will take another two decades before the mass of Chinese become consumers in the accepted sense.

But few corporate business plans take a realistic view of the commercial opportunities in China. Mobile phones are a good example. Thanks to soaring demand for handsets, America's Motorola, which started up in China in 1987, is now the biggest foreign company there, with locally generated revenues of $5.7 billion in 2002. China, in turn, has become Motorola's second-largest market, worth 14% of group sales. But now the company is on the defensive. Growth is levelling off, even though market penetration is only around 20%, suggesting that most people who can afford a mobile phone already have one.

At the same time, a newish crop of domestic handset producers has doubled its market share to 40% in the past 18 months, threatening a glut. Brian Modoff of Deutsche Bank in San Francisco says that China has 40 mobile-phone makers selling over 800 models. Annual demand should rise from 80m units to 100m in the next two years, but supply will double to 200m. Prices are plummeting. With government backing, Ningbo Bird and TCL, two Chinese manufacturers, have overtaken both Motorola and Nokia with their 10% market share, though a lot of their “sales” are simply sitting in warehouses. But that is no comfort to Motorola. Daniel Shih, the president of its operation in China, admits he faces “extreme competition”, though he claims to be “very happy” with handset margins in China. Mr Modoff, however, reckons they are even thinner than the group's poor 6% global average.

The competitors are not finding life much easier. In Ningbo, a coastal town in Zhejiang province, Bird's modern factory is full of industrious workers and high-tech machines, but Dai Maoyu, Bird's executive vice-president, looks tired. The former economics professor says he is making phones he cannot sell, that a price war is destroying everyone's margins and that Bird wants to diversify into cars.

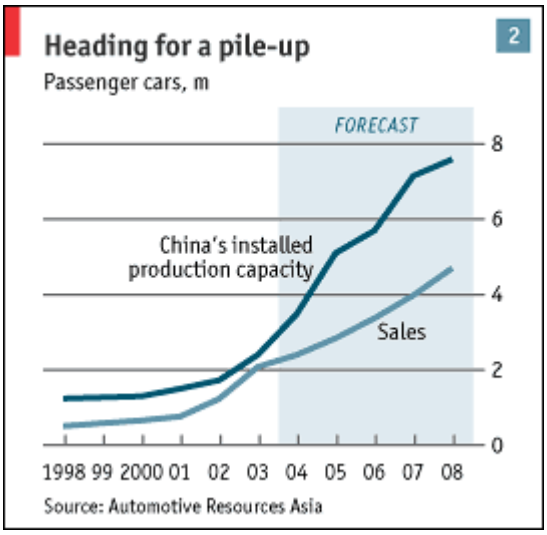
Hot airbags

He is not alone. Cars are China's hottest consumer product. Sales of locally made passenger cars jumped by 50% in 2002 and by 75% last year, to 1.97m, as ministerial purchases of dated VW Santanas were replaced by entrepreneurs buying their first Honda Accords and Buick Regals. Even the professionals were surprised. “There wasn't anyone anywhere in the world in 2001 who forecast even close to what we've seen,” says Philip Murtaugh, chairman of General Motors China. He predicts that China, having overtaken Germany in 2003, could surpass Japan as the world's second-largest new-car market after America in two years.

Mr Murtaugh expects annual growth of 10-15% until 2010. Many private analysts are even more bullish, forecasting 20-25%. The previous spurt in car sales in 1991-92 was followed by years of single-digit growth, but strong private demand may prevent such a slowdown this time. There are still one-year waiting lists for many models, despite tariffs that virtually block imports and keep prices high.

Yet those high prices in themselves are bound to limit the size of the car market. Michael Dunne, president of Automotive Resources Asia, a consultancy, says a third of the cars sold last year cost more than $25,000, and 70% were paid for in cash: “China's rich are not a limitless pool. There is talk of an emerging middle class, but I don't see it.”

For now, this may not matter. With prices and capacity utilisation high, the big Sino-foreign joint ventures are making money hand over fist, so they are ramping up capacity (see chart 2). In the past year, GM, Volkswagen, Toyota, Honda, Nissan, Peugeot Citroën, DaimlerChrysler and Ford between them have announced more than $20 billion of fresh investment. KPMG, a consultancy, forecasts that next year overcapacity will reach 90%, with China producing 4.9m cars when demand is for only 2.6m. Add in trucks, and total vehicle output could reach 15m by 2007, against sales of only 7m, according to the National Development and Reform Commission (NDRC), the economic-planning arm of China's cabinet.



Mr Murtaugh calls overcapacity concerns “overblown”. He thinks that the first to suffer from competition will be the small, indigenous manufacturers among China's 120 carmakers. Looking round his Shanghai Buick factory, which churns out 33.5 cars an hour, six days a week, with every one sold, it is easy to be sanguine. But the big producers will be hit eventually. Car prices are falling by 10-15% a year. Yet it costs 5% more to build a Buick in Shanghai than in Detroit, because expensive imported materials outweigh cheap local labour, so margins are being squeezed. Average operating margins for the sector, at 8-9% last year, were high by global standards. But Goldman Sachs estimates that in the past 18 months, eroding market share and prices have halved the Chinese margins of the market leader, VW, to 5.8%.

Cheaper cars will attract more consumers. But at the bottom of the market the indigenous Chinese carmakers are more competitive than the incomers, and the government is unlikely to cede the market to foreign-led ventures forever. Mr Murtaugh dismisses talk that a “car policy” document drafted by the NDRC will give half the market to local makers by 2010, but local car companies such as Geely and Chery are unofficially being encouraged to pirate foreign designs.

Undoubtedly China's potential is huge, and there are more multinationals making money there today than ever before. But for most foreigners, the market will turn out to be smaller than expected and take longer to develop; and because so many foreign businesses are piling in, competition is likely to be fierce. The question then becomes: how can foreign firms generate acceptable returns in China?

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Bulls in a China shop

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Foreign companies are pouring money into China. But is the investment paying off?

WELDING torches glow orange through the smog. A tangle of silver pipes and concrete structures cover the rutted ground from which the central naphtha cracker is starting to rise. Workers clamber everywhere. Here, near Nanjing in Jiangsu province, BASF is building China's most modern integrated petrochemical complex, the first to be partly funded by foreign money and kitted out with foreign technology. If the plant starts on schedule in 2005, says Bernd Blumenberg, president of BASF-YPC (the German chemical group's joint venture with a subsidiary of China's oil giant, Sinopec), 12,000 workers will have spent 72m hours using 150,000 tonnes of steel in one of the largest industrial construction projects in the world.

Yet this $3.7 billion monster is only the first—and not even the biggest—of six being planned in China. It seems that every multinational in the world is either in China already or declaring that it “cannot afford not to be”. Last year, despite SARS and the Iraq war, China attracted a record $57 billion of foreign direct investment. Contracted FDI, an indicator of future investment, soared 39% to $115 billion.

Unfortunately, few foreign companies have had much to show for their enthusiasm since Deng Xiaoping re-opened the country to the world in 1992 after the Tiananmen Square clampdown. In China, first-mover advantage has often turned into first-mover curse. Early entrants, seduced by quick successes among affluent consumers in one or two cities, decided to tackle the mass market, only to encounter lower prices, fragmented customer bases, haphazard distribution and vicious domestic competition. Most responded by pouring in more resources, becoming ensnared in what Hubert Hsu and Jim Hemerling of the Boston Consulting Group call the “value trap”—the more they invested, the more money they lost.

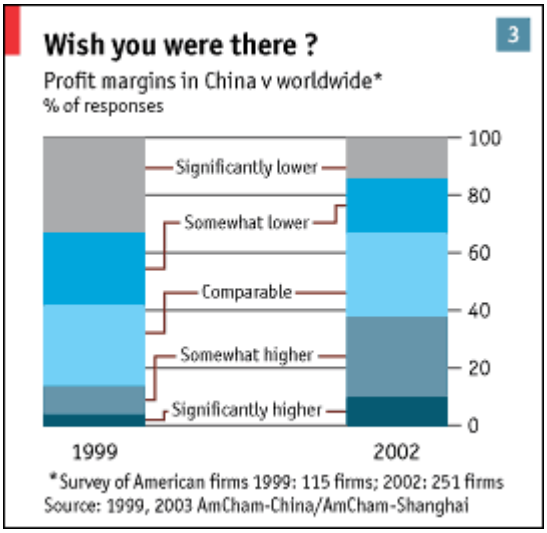
The world's top brewers squandered hundreds of millions of dollars in China in the 1990s. The average net profit margin of China's 400 brewers (including foreign ventures) now is just 0.5%. Losses are common for companies in packaged food, food retailing, household goods and personal care. The only foreigners to have consistently done well have ignored the domestic market and concentrated on China as a cheap base for manufacturing and export processing.

Most of these are ethnic Chinese, mainly from Taiwan, whose companies have invested more than $100 billion on the mainland, and from Hong Kong. A 2002 study by the Federation of Hong Kong Industries found 59,000 Hong Kong-owned factories in China, mainly just across the border in Guangdong province, making everything from toys to clothes and employing 11m people. These small exporters are probably the most profitable outside investors in China. One reason, notes Gordon Redding, professor of Asian business at INSEAD, a business school near Paris, is that Chinese business people understand better than western ones how to manage uncertainty and line up long-term political support.

Connections have certainly worked for Vincent Lo, a Hong Kong property developer whose Shui On group is now one of the largest cement makers in China. Dubbed the “king of *guanxi*” (connections), Mr Lo made his first big splash redeveloping Shanghai's run-down Xintiandi district, to the delight of city officials. He then took his cue from the government's “Go west” policy, moving from coastal cities to backward inland ones such as Chongqing in central China. There he won permission to buy dilapidated cement plants by promising local bureaucrats not to lay off a single worker. Mr Lo's flexibility and patience have allowed him to cash in on an infrastructure boom around Chongqing. He laughs at “Americans [who] always want to bring in whole teams of lawyers and negotiate contracts—they will be there forever.”

Even the Americans, however, seem to have learned a thing or two. In a survey of its members by the American Chamber of Commerce in China in 2002, three-quarters claimed to be profitable, and nearly 40% said their margins in China were higher than their global margins (see chart 3). “There is no doubt that companies are doing better than they were,” says the chamber's then chairman, Chris Murck.

Do it yourself



Rapid economic growth has lifted the China operations of most foreign companies. But the multinationals have also learned a lot. Flexibility, as Mr Lo found, is critical. Danone, a French food group, has won plaudits in China by switching from an organic-growth strategy for its dairy products to buying up local rivals in the late 1990s. By contrast, Procter & Gamble failed to adapt, according to A.T. Kearney, a management consultancy. Its focus on shampoo worked well initially, but it confused customers with too many brands and found itself undercut by local rivals, which meant that its market share dropped from over 50% in 1998 to 30% in 2002. Now it plans to attack rural markets, a tough call.

At least P&G chose a weak joint-venture partner it could control. By contrast, Unilever invested in a host of categories it failed to dominate and chose a strong partner, leading to a string of disagreements. Unilever's Mr Gunning admits: “A Chinese joint venture is incredibly difficult.” Even Kevin McCann, the former boss of Audi China, says: “No joint venture is ever good,” although VW's partnership with Shanghai Automotive (SAIC) has been one of the most profitable.

Examples abound. An American businessman in north-eastern Shenyang tells of boxes of car parts piled outside a warehouse run by Jinbei GM, GM's joint-venture partner there. The warehouse manager had apparently been stealing the equivalent of five cars a night for years, “with the implicit approval of GM's partner”. Confronted with the tale, GM's Mr Murtaugh concedes that: “We've had some problems with that joint venture.” Such stories explain why multinationals are opting for wholly foreign-owned enterprises, or “Woofies”, wherever possible.

The foreigners with the best chance of success in the difficult domestic market are those selling goods and services that local firms need, such as iron, cement and steel, or that will take years to develop. The international investment banks make around $500m a year in underwriting, equity sales and advisory fees. Lawyers, advertising agencies and accountants have strategic expertise to offer, and educational services, especially English-language materials, are a booming niche.

Similarly, as demand for air travel soars, China's airlines need more planes, and with domestic firms decades away from being able to make big aircraft, the two global suppliers, Airbus and Boeing, are in a sweet spot. Though a late entrant, Airbus is winning orders for relatively little investment. Laurence Barron, president of Airbus China, says it will be “politically correct” for the company to quadruple the $15m of manufacturing contracts it currently awards to Chinese firms by 2007. But that should also lower its costs.

The product does not even have to be sophisticated. With 1,000 outlets on the mainland, Kentucky Fried Chicken is China's leading fast-food chain. Samuel Su, China president for its American parent, Yum! Brands, says it has been successful because it offers the Chinese a rare combination of safe, tasty food in clean surroundings with American cachet, all at a reasonable price.

For those who have to battle against local, often unfairly subsidised competition, success usually requires a dash of unorthodoxy. Honda entered China late but cheaply, snapping up Peugeot's Guangzhou plant for $250m in 1998 when the French retreated. Counter-intuitively, Honda then sold its Accord as a luxury sedan to businessmen, rather than betting on a cheap family car like its rivals. Production and profits have soared ever since.

Carrefour, a French hypermarket retailer, has built up China's second-largest chain of stores by ignoring the requirement for central-government approval of retail joint ventures. Instead, it signed deals with local city governments, in the expectation that once the stores were open, the central government would not shut them down. It worked.

But in absolute terms the earnings of foreign firms in China are almost certainly still small. A study of American Commerce Department data conducted by a research publication, *China Economic Quarterly*, showed that direct and indirect profits made by American affiliates in China amounted to $2.8 billion in 2001—less than the $4.4 billion made in Mexico, with a population of just 100m.

Although profitability has undoubtedly improved, many companies are not even covering their cost of capital, much less getting a proper return on their investment. Norman Villamin at Morgan Stanley says that some multinationals deliberately lower the required rates of return for their China operations to wave through projects that would not usually qualify, and charge costs to head office to make the China arm seem more profitable than it is.

Foreign investors that concentrate on exports or use China as a source of goods, such as Wal-Mart, will definitely benefit from the mainland's cheap labour. “Businessmen should take the low-hanging fruit and limit their investment,” argues Kenneth Lieberthal, a China expert at the University of Michigan Business School. A few large multinationals, notably General Electric, are planning to go much further, moving advanced production lines and research facilities there in order to transform their entire corporate cost base. But many of those lured to China for the domestic market will struggle to generate sustainable profits. And all foreign companies have to face the fact that China is still not a rational place to do business.

AP

Chopstick-lickin' good

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A disorderly heaven

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Most foreigners underestimate the eccentric nature of China's business environment

“THERE is great disorder under heaven. The situation is excellent.” Chairman Mao's aphorism encapsulates a lesson all foreign businesspeople should take to heart: the Chinese scent profit in chaos. When it comes to doing business in China, the first rule is to throw away the rulebook, along with the business-school texts and western management theory.

Of far more use would be a new book by a man who spent ten years actually trying to run companies on the ground. In “Mr China”, to be published next month, Tim Clissold tells the thinly disguised story of Asimco, one of the largest foreign investors in the country at the time. Started in the early 1990s by Jack Perkowski, a Wall Street banker, and run by Mr Clissold, a British accountant, Asimco raised $434m, invested it in a series of car-component factories and breweries—and watched almost all of it drain away within a decade.

It made no difference that Asimco screened hundreds of factories before making its first investment; that it always insisted on majority control and put in its own managers and accountants; that Mr Clissold spoke fluent Mandarin and spent much time and effort courting officials at every level. The Chinese, it seems, were always one step ahead.

Mr Sha, the company's best manager, who ran a rubber-parts factory in the mountains of Anhui province in central China, secretly set up a rival plant down the valley which he financed by siphoning money from the Asimco joint venture. When he was eventually found out and fired, he told his workers to package defective products from his own production line in Asimco crates and sent them to its customers so they would cancel orders. “There were pitched battles on the street with knives and broken bottles, and the army was called out,” says Mr Clissold. In Zhuhai, near the border with Macau, the director of Asimco's brake-pads factory absconded to America with $10m-worth of letters of credit, leaving behind his entire family. Asimco sued the bank for validating the certificates, but ended up liable for the lot. A local anti-corruption official promised Mr Clissold he would investigate, but only if he got a car and working capital. In 1998, after eight years of frustration and back-breaking work, Mr Clissold, at the age of 38, suffered a total collapse.

His book is at its most telling in describing the attitude of Asimco's New York board members and investors, which included some of America's top mutual funds and banks. They had a stock answer for every problem—fire the manager, cut costs, find new customers—in blissful ignorance of local conditions.

Asimco's story is unusual only in its detail. Many other companies have similar tales to tell. America's PepsiCo has spent more than a year trying to undo its tie-up with a joint-venture bottler in Sichuan after its manager secretly sold the venture to a local-government bureau to buy himself expensive holidays and cars. James Bryant, who runs Subway's Beijing sandwich franchise from a grim office, describes how his Chinese joint-venture partner (now in jail) swindled the company out of $200,000. “People leave their heads at home when they come here,” Mr Bryant says. “They forget all about due diligence. They meet a guy on the street, give him a ton of money to run something and six months later he absconds with it.” After nine years in China, Subway operates just 30 restaurants, rather than the 2,000 it once envisaged.

Many of the problems foreigners encounter reflect the fundamentally non-rational nature of China's business environment. This can be summed up under three headings. The first is bureaucratic. Donald Lewis, a law professor at the University of Hong Kong, argues that if the great invention of European civilisation was a legal system, China's was bureaucracy. The communists simply took over the imperial civil service and added a further layer of complexity by superimposing a party organisation on the government one.

McDonnell Douglas for one fell foul of the system. After an early entry into China in the 1970s, the (then

independent) aircraft maker thought it had outwitted Boeing when it signed a $6 billion deal in 1991 to build 150 airliners for China locally in partnership with Avic, China's state aerospace group. With such gold-plated backing, the Americans assumed that China's government-owned national and regional airlines would buy their planes.

But the airlines, represented by a rival ministry, preferred to buy their aircraft direct from Airbus and Boeing, which were cheaper and offered the bureaucrats “factory tours”, mostly to Disneyland. Only two McDonnell planes were ever built in China, and the company lost a packet on the contract, which was cancelled in 1997. As Mr Studwell writes in “The China Dream”, “Douglas's returns from more than two decades in China were 40 Sino-US marriages among its staff and untold embarrassment.”

Another bureaucratic complication is the power struggle between the centre and the provinces. “The mightiest dragon cannot crush the local snake,” goes a favourite 16th-century saying in a country traditionally run on decentralised lines. The central government in Beijing may appear all-powerful to outsiders, but in practice its reach is limited. Local officials and party bosses hold sway not only in individual provinces and cities but even in the smallest villages. “The centre has no control over the provinces,” says Michael Enright, a professor at the University of Hong Kong School of Business. “When it sends people to investigate illegal pirating of CDs, local governors block access to the factories.”

Currently, this problem shows up most clearly in China's foot-dragging compliance with the requirements of the WTO. Whereas the central government is keen to lower trade barriers and increase competition, local barons, afraid of unemployment and instability in their own backyards, are withholding their co-operation.

Chinese bureaucracy also gets in the way in sensitive industries such as cars and technology, where a centrally directed industrial policy appears to be allocating a share of the market to domestic companies. From this summer, foreign makers of wireless technology must rejig their software to a Chinese standard “in the interests of national security”. This new rule will force companies such as Sony and Intel to work with officially designated Chinese partners, exposing their intellectual property to the risk of piracy.

All too frequently, a short-sighted central government seems to regard foreign companies as cash cows to be milked. For example, plans are afoot to fund a rural postal service by slapping a tax on the (largely foreign) logistics industry, which could cost 800,000 new jobs, according to the US-China Business Council. David Cunningham, Asia Pacific president for Federal Express, fumes: “Why should we fund a Chinese postal service any more than a Chinese steel plant?”

A law unto itself

The second problem for foreigners is a direct consequence of the bureaucratic system of government: China is subject to the “rule of man” rather than the “rule of law”. Rights derive from political power, generally the power of an individual, which explains the importance of personal connections, or *guanxi*.

Granted, China has come a long way since 1978, when it had no formal legal system at all. In the past 20 years it has seen one of the greatest floods of legislation in history. But although China may have laws for most things, enforcement is weak. China needs far more than the 100,000 lawyers it currently has, most of them poorly trained and badly paid.

There is no comprehensive bankruptcy law to protect businesses. A long-awaited draft is still in the works, and even that is more about closing down enterprises than about looking after creditors' interests. Nor is there an effective way to resolve contract disputes. Some foreigners, such as Sumitomo Chemical, have sued their local partner in the Chinese courts, only to destroy their business relationships. Others, such as Newbridge Capital, an American venture-capital firm, have turned to international arbitration.

“Chinese legislation is chock full of ambiguities”, says Lester Ross, a Beijing-based lawyer. He thinks this will take 10-15 years to resolve. Donald Clarke, a law professor and China specialist at the University of Washington, is more pessimistic: “Look at the US legal system in the 1920s. It took over 80 years to modernise.”

The transition from a power-based planned economy to a rule-based market economy has opened the door to endemic corruption. Most foreign companies must deal with constant bribe-taking and the theft of property. They cannot trust the corporate governance or the accounts of Chinese joint-venture partners, and sometimes find it hard even to establish clear title to land and physical equipment. Not surprisingly,

many foreign companies (especially struggling ones) lose sight of their own ethical standards: “I have a hard time believing foreigners can succeed in China and keep their hands clean,” says one senior American consular official.

The name of the game

The third distinct challenge of operating in China is cultural. It is not just that the language is difficult and frustratingly imprecise at times, that the country is huge and the working conditions are often appalling, from freezing offices to constant traffic jams and a permanent pall of pollution. Most foreign businessmen who have been there for any length of time say they are baffled by the attitude of their local counterparts. “Often it is not about doing the best deal, but about scoring points,” says one. The Chinese often seem to be driven by emotions more than business logic. Some westerners accuse them of racism.

The concept of “face”—gaining it, preserving it—matters above all, and deception to wrong-foot an “opponent” is an accepted form of negotiation. Bill Young, an American who has worked in China since 1985, originally for McDonnell Douglas and now running a boiler business in Shenyang, recalls that in one round of talks with a customer, “the stenographer in the corner turned out to be the CEO.” An almost ritual test of face for foreigners is the official banquet, where the Chinese host will delight in serving up exotically revolting dishes (Mr Clissold has eaten everything from scorpions to deer's penis) and try to get his guests drunk on *bai jiu*, a liquor that tastes rather like diesel oil.

The way Mr Clissold tells it, “I was dealing with a society that had no rules; or more accurately, plenty of rules but they were seldom enforced. China appeared to be run by masterful showmen: appearances mattered more than substance, rules were there to be distorted and success came through outfacing an opponent.” The best way to prosper, therefore, is to play China by Chinese rules, a lesson that too few companies have learned. BAT, a tobacco company that has been in China since before 1949, proved more adaptable than most. One of its more aggressive marketing tactics was to buy up stocks of rival cigarettes, hold them until they were mouldy and then sell them on.

Despite all these problems, foreign investors continue to pour money into China (even Mr Clissold is still there, now working for Goldman Sachs). Whether the country will ever become a more rational and more profitable place in which to do business will depend largely on whether it can reform its state corporations, allow its private companies their head and salvage its financial system—the subjects of the remainder of this survey.

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We are the champions

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China's state-owned enterprises want to make their mark on the world stage. They will struggle

DALIAN, the port city of Liaoning province in China's north-east, is home to the country's biggest, most modern shipyard. In the cavernous dry dock, a modern crane lifts massive steel sections for final assembly of a gigantic oil tanker ordered by Iran. The din is deafening as workers hammer and weld the parts together.

Ten minutes' drive away there is noise of another kind: children laughing as they play basketball during a break from lessons. Their school, a shabby concrete building with bitterly cold classrooms, looks out of place amongst Dalian's grand Russian- and Japanese-inspired architecture, and wholly unconnected to the gleaming shipyard. Yet both are part of the same state-owned enterprise, Dalian New Shipbuilding Heavy Industries.

“Theoretically, it would be better to get rid of the school,” says Sun Zhenlie, the company's vice-president. “In reality, it is not that easy.” Yet the school is only one of the group's non-shipbuilding activities. Along with routine overmanning, it helps to explain why productivity at Dalian New Shipbuilding, despite cheap labour, the latest equipment and subsidised loans, is just one-seventh to one-tenth that of its Japanese and South Korean rivals.

Several hundred miles further north, the contradictions are even sharper. Daqing, in Heilongjiang province, is at the centre of China's largest oil field. More than 50,000 “nodding donkeys” dot the city centre and the surrounding desolate plain. The production facilities are owned by PetroChina, an arm of China National Petroleum Corporation so thoroughly restructured that it is listed on the New York Stock Exchange. Warren Buffett, America's smartest investor, owns a stake.

Yet through its ties to CNPC, PetroChina in effect still pays for the main hotel and some restaurants in Daqing, as well as for the housing, heating and even wages of thousands of laid-off workers. To divert attention from Daqing's troubles, local officials drag visitors to a museum commemorating “Iron Man” Wang, an oil worker who in the 1960s helped to cap a blazing wellhead by jumping into a vat of badly mixed concrete. He survived the feat, but his famous slogan, “I will get the oil, even if it takes 20 years off my life”, proved prophetic: he died in 1970, aged only 47.

The contrast between old and new in the state sector is at its starkest in China's north-eastern “rustbelt”, where state-owned enterprises (SOEs) generate 70% of GDP. But it exists throughout the country, and shows how much further SOE reform has to go.

It is no exaggeration to say that China's economic future depends on such reform. In 2002, the state controlled half of industrial output, and SOEs still account for 35% of urban employment, despite having halved their workforce in the past 12 years. Virtually all of China's heavy industry and much of its technology is in state hands. Half of all bank loans go to SOEs. This crowds out the private sector, China's growth engine, and threatens the entire financial system, because most of those loans will never be repaid.

This is not to deny that progress has been made. When state corporations were set up in the 1960s, they were simply arms of government bureaucracies, which told them what to make, took all their revenues and covered all their costs. Factories were, in effect, “little societies”, responsible for everything from education and medical care to housing and recreation. That they made huge losses did not matter.

Don't let go

It was only in March 1998, when Zhu Rongji became prime minister, that reform of the sick state sector moved to the top of the political agenda. He enunciated the doctrine of *zhuada fangxiao* ("grasp the big, let go the small"), which remains the guiding principle of SOE restructuring. It means that the government wants to keep control of the biggest and most important companies, but will let the smaller ones fend for themselves.

The following five years saw a wave of incorporations and stockmarket listings of SOEs, big and small, as the central government and the provinces sold minority stakes. Urged on by the centre, local officials organised auctions of state assets, most of which were sold at rock-bottom prices to managers and party bosses. Eventually the government had to call a halt.

Meanwhile, restructuring, mergers and closures reduced the number of SOEs from 262,000 in 1997 to 174,000 in 2001. Lay-offs reached such a scale that they triggered serious unrest. In early 2002, thousands of oil workers gathered in Iron Man Square in Daqing to protest against unfair severance packages. The government quietly rounded up and imprisoned the ringleaders, but in March 2003 it also set up a new agency to oversee the SOEs' management: the State-Owned Assets Supervision and Administration Commission (SASAC).

Since SASAC started life, its chairman, Li Rongrong, has announced nothing but good news. In the 11 months to November 2003, China's top 500 SOEs reported revenues of 4.07 trillion yuan ($492 billion), up 25% on a year earlier, and profits of 334 billion yuan, up 33%. Only 87 of the 500 were still making losses.

Unfortunately, these numbers cannot be taken seriously. Outright fraud aside, most SOE managers do not know what their real profits are, and tell their superiors what they want to hear. Most of the jump in official profits is due to a windfall the big oil producers reaped from high world prices, and to lower interest costs as banks have swapped dud loans for equity.

China's 1,287 domestically listed companies, most of which are SOEs, reported an average return on assets of 6.2% for the first nine months of 2003. But again, this improvement is down to a few star performers. Stephen Green at London's Royal Institute of International Affairs says 42% of all listed-company profits come from just 20 companies, including Sinopec, Angang Steel and protected sectors such as utilities. The majority of SOEs are running at break-even or worse (see chart 4).

According to a study by the World Bank's William Mako and Chulin Zhang, published last September, overall profitability of SOEs doubled between 1999 and 2001 but 51% of all state corporations were still losing money. Moreover, average current assets had risen to 319 days-worth of annual sales, suggesting that most of the SOEs' working capital was tied up in uncollectable bills or unsaleable inventory. In other words, most SOEs are illiquid, kept alive only by government money.

What SOEs are for

For China's top leadership, this is beside the point. SOE reform is not about profits, and certainly not about privatisation. The aim is not to reduce the state's control over key sectors of the economy, but to make that control more effective. If a stockmarket listing or the sale of a stake can bring in technology, private-sector expertise and discipline, well and good. But the government intends to remain in control.

Nor is the purpose of SOEs to maximise wealth. They merely need to be efficient and big enough to have a strong international presence. China's desire to become a superpower partly depends on its industrial policy. Having watched the breakneck expansion of foreign multinationals over the past decade, it wants to create its own global stars. SASAC's real mandate is the transformation of a group of 30-50 SOEs into globally competitive "national champions" by 2010.

National champions 5

2002, $bn

	Sector	Revenue	Net income	Market capitalisation*
PetroChina	Oil/gas	29.5	5.7	90.7
China Mobile	Mobile telecoms	15.5	4.0	65.4
Sinopec	Oil/gas	39.2	1.9	51.9
CNOOC	Oil/gas	3.2	1.1	16.8
Baosteel	Steel	4.1	0.6	11.1
China Aluminium	Aluminium	2.0	0.2	8.4
Shanghai Auto (SAIC)	Cars	0.6	0.1	4.6
Legend†	PCs	2.6	0.1	2.9
TCL	TVs/electronics	2.7	0.05	2.9
Qingdao Haier	White/brown goods	1.4	0.05	1.0

Sources: Annual reports; Bloomberg

*February 2004 †Year to March 2003

Some, notably the three big oil companies, Baosteel, Haier (household appliances) and TCL (electronics), seem to be on their way. They have vast assets, healthy profits and listed subsidiaries (see table 5). Increasingly, they are also buying assets overseas. The three oil groups have operations in more than a dozen countries. CNOOC is now Indonesia's largest offshore oil producer, following its $585m takeover in 2002 of Repsol's operations there. In Brazil, Baosteel, China's biggest steelmaker, has negotiated China's biggest ever overseas corporate investment, worth $1.5 billion. With the resources of an ambitious government and a huge, protected domestic market behind them, their progress seems inevitable.

But is it? Only 11 Chinese companies rank in the *Fortune* 500 list of top global firms by revenue, and only two are in the FT 500, ranked by market value. Not a single Chinese brand makes the top 100 list of Interbrand, a consultancy, and “global” companies such as Haier are still confined to niches overseas. Peter Nolan, a professor at the Judge Institute of Management at Britain's Cambridge University and an expert on Chinese companies, comes to a withering conclusion: “China has not built a truly competitive global firm. Its industrial policy of the past two decades must be judged a failure.” All this despite tariff protection, cheap loans, access to foreign technology through joint ventures and privileged access to the stockmarket.

Avic, the national aerospace group, is a good example. Urged on by Deng, by 1985 it had designed a civil airliner from scratch in less than five years. But only two planes were ever built, and even China's nationalised airlines refused to buy. Nearly 20 years later, Avic is trying again with a small regional jet and plenty of tax breaks, but it has no clear idea of its commercial prospects. In pharmaceuticals, Sanjiu, the local contender, lost to foreign rivals because it concentrated on traditional Chinese medicine rather than developing a proper R&D capability, and diversified into biscuits and beer.

Feet of clay

The reasons for failure are plentiful. Mr Nolan points to inconsistent central policy, provincial protectionism that prevents companies from buying up competitors and an inability to reduce overmanning because of the premium placed on low unemployment and social stability. Xie Qihua, the president of Baosteel, saw her company's profitability drastically reduced in the mid-1990s when the government forced her to absorb four rival loss-making steel producers.

Michigan University's Kenneth Lieberthal and Bain's Geoffrey Lieberthal, a father and son writing in the *Harvard Business Review*, blame weak management. For SOE bosses, political skills matter more than modern management practices. The companies' middle managers are hierarchically minded and display little initiative. They can carry out specific tasks, but fail to grasp the complex processes required to manage a large-scale business.

Technology is another Achilles heel. China runs a deficit on its technology trade with the rest of the world, and 80% of technological imports and exports are controlled by foreign-owned firms in China. The Chinese have made little progress in either basic research or in advanced design in vital industries. In the rest of the world, meanwhile, technological development and a wave of consolidation have produced lots of genuinely global companies. If anything, the gap between these multinationals and their Chinese counterparts has widened, Mr Nolan says. Foreign companies will not readily hand over their technology

or management skills to a Chinese partner. And cosseted Chinese companies will have to play by international rules the moment they venture abroad.

Huawei, China's leading telecoms-equipment maker, knows this to its cost. At first sight, it looks every bit the global success. Its marbled headquarters in landscaped grounds is a world away from the chaos of nearby Shenzhen city. Last year $1 billion of its total sales of $3.5 billion was earned outside China. Yet critics argue that Huawei owes much of its success to peculiarly Chinese advantages, such as military connections and lax laws governing the theft of intellectual property. William Xu, the company's executive vice-president, hotly denies it has had government help, claiming it is privately owned and run like a western company. Yet Huawei is finding it harder to compete internationally than at home. In a highly publicised case last year, it was sued by Cisco in a Texas court for infringing its intellectual property, and will have to make amends.

Inspired by the “Iron Man spirit”, China will no doubt continue to build its global champions. But like Mr Wang, they may find that life on the world stage can be nasty, brutish and short.

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On the capitalist road

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Private businesses are China's great hope for the future

IF CHINA'S north-east with its hulking state-owned industries is a monument to socialism, Zhejiang province, hugging the coast just south of Shanghai, is its capitalist heartland. Combining an entrepreneurial trading heritage with a meticulous division of labour, Zhejiang's family-controlled businesses are taking global markets by storm. In the city of Wenzhou, 3,000 small firms have clubbed together to concentrate on making cigarette lighters, some specialising in components, some in final assembly. Production is flexible, fast and competitive: in 2002, Wenzhou made 750m lighters, the equivalent of 70% of world demand.

Companies elsewhere in Wenzhou manufacture nothing but pens or low-voltage electrical equipment. Cixi is a base for kitchen-equipment makers, and Datang turns out 8 billion pairs of socks a year from 8,000 factories—one-third of all socks sold worldwide. Other parts of the province make vast quantities of shoes, toys, ties, watch movements and Christmas decorations.

These businesses are creating real wealth. Zhejiang's annual income per person among urban residents of 12,700 yuan (a little over $1,500) in 2002 was the third-highest among China's 31 administrative areas, behind only Shanghai and Beijing. On average, the people of Zhejiang earned nearly twice as much as those in the north-east. The province was also home to 62 of the 400 richest Chinese, a third more even than prosperous Guangdong.

Zhejiang's success comes down to one simple fact: 91% of its 240,000 enterprises, with annual revenues of 700 billion yuan in 2002, are privately owned. They also have access (albeit limited) to funds from local private moneylenders and clarity of ownership, rare in China. The government, both at local and national level, deserves credit for its benign neglect of them.

Zhejiang's home-grown capitalism is exceptional in China, and will probably remain so. It was a fortunate accident of history that the communists decided not to base large state projects in an area close to the island of Taiwan, a potential war zone, says Jonathan Zhang, an investment consultant for the Huangzhou city government. That created a vacuum for Zhejiang's risk-taking traders to thrive in. But everywhere in China, private business is springing up in the cracks between state-owned enterprises as well as in new fields such as service industries.

Guangdong and Jiangsu (also opposite Taiwan) were long ago turned into giant export-processing factories by the investments of ethnic Chinese from Hong Kong and Taiwan; and mainland citizens who have lived abroad are flooding back to set up companies in China's countless business parks and make their fortune. Charles Zhang, the MIT-educated founder of Sohu.com, a Nasdaq-listed Internet portal, who returned home in 1996, is now worth an estimated $270m (see article).

It is hard to say just how big the private sector is. Some state businesses are, in effect, run on private lines by their management. Conversely, many firms labelled private by the official statistics, particularly small township, village enterprises (TVEs) and collectives owned by their employees, are in truth controlled by local governments. Bao Yujun, chairman of the Research Association on the Private Economy, a Beijing-based think-tank, reckons the private sector contributes just over 60% of GDP, counting TVEs and businesses with foreign investors (worth about 15%). Yet the World Bank's Country Assistance Strategy report in January 2003 put the share as low as a third.

The private sector steams ahead

Whatever its precise size, the private sector has, in the World Bank's words, “emerged as the most dynamic component of the Chinese economy”. Growing at around 20% a year, more than twice as fast as the economy as a whole, it has been responsible for most of the recent job creation and for up to 60% of fixed capital investment. According to an IMF working paper by Ray Brooks and Ran Tao, published last November, agriculture and the SOEs have been shedding workers, but China's private companies created 17.5m jobs in the six years to 2001. Another 75m quasi-private jobs have sprung up in the “shadow economy”, outside the official statistics, in street vending, casual construction work and domestic service.

Most private companies are still tiny: 90% employ fewer than eight people. But the number of larger private enterprises is growing. Some are old-fashioned exporters, taking advantage of a low domestic cost base. Galanz makes one in three microwaves sold the world over, and Pearl River Piano is the globe's second-largest piano maker. Others, such as Legend, the nation's number one PC manufacturer, and collectively owned Haier, the leading white-goods producer, are building respectable domestic brands.

One such group is Wahaha, a maker of soft drinks, named to sound like a laughing baby. Founded in Hangzhou in 1987 by Zong Qinghou, Wahaha began by selling vitamin drinks. In 1991 Mr Zong had to sell a stake to the district government. In 1996 he sold a further slice to France's Danone to bring in new technology and product lines. On paper Danone now has 51% of the company, but Mr Zong runs the company like his own fief, to good effect. The group has 16% of China's bottled-drinks market, and its “Future Cola” is the third-largest domestic cola supplier behind Coke and Pepsi, achieving higher margins than they do thanks to its local knowledge.

Unequal struggle

Despite such successes, China's private sector as a whole does not enjoy a level playing field. One fundamental issue is property rights. China's 1982 constitution caused an explosion of entrepreneurial activity by legitimising the “individual economy” alongside the socialist public one. Amendments in 1988 referred to the “private economy”, and a year later private activity was dubbed an important part of a “socialist market economy”. But only now, in yet another amendment brought in this month, does the constitution declare private property “inviolable”. And even now, public ownership retains preferred status. The constitution still refers to it as “sacred”.

This matters. As private businesses grow, they come into contact with state-sector suppliers, distributors and customers, and often find that their theoretical property rights count for little when it comes to collecting debts or having contracts honoured. Moreover, the government is still inclined to meddle, even taking stakes and muddying ownership. And rules, regulations and bureaucratic fiats abound, many of them conflicting.

From political access to obtaining official licences to matters like unsupervised travel, the discrimination in favour of SOEs is always in evidence. Mr Bao talks fervently of a need to “change the mindset” in China. “Under the planned economy, private businesses cannot enjoy equal treatment,” he says. His think-tank's shabby office on the outskirts of Beijing, complete with a rusting bed and a well-used spittoon, bear testimony to the second-class status of the private sector.

This discrimination is reflected most critically in a lack of access to capital. Bank loans still go overwhelmingly to state corporations, as do stockmarket listings. Indeed, although SOEs represent far worse credit risks than many private companies, loans to them are classified as more secure, forcing private businesses to rely on money raised from friends and family and on retained earnings.

That, however, is not the only reason why most private companies remain small. Nowhere is the Chinese propensity to base business on relationships more obvious than in the family-run firms that make up the bulk of the private sector. The dominance of a single individual gives them clear lines of command and enormous flexibility. But as they grow, they run up against the limits of what one person can manage. In contrast to the West, argues INSEAD's Gordon Redding, in China “a culture that transcends the individual is exceptionally rare”.

Another problem is that most Chinese businesses are broad rather than deep, preferring to diversify rather than concentrating on a core business. This reflects a huge range of money-making opportunities and a lack of individual patience. Kenichi Ohmae, a consultant who used to run McKinsey's operation in Japan, says it took the Japanese 40 years to develop the sophisticated products and the quality control that allowed them to prosper. “I see very few Chinese managers excelling in one area,” he says. “Chinese managers will never spend five or ten years developing a smaller, faster component—it is not in their mentality.” Such short-termism helps to explain why China is struggling to build home-grown brands. The consistency and quality that builds trust with consumers is not part of the Chinese management style.

The development of a vibrant private sector has been China's greatest commercial achievement since opening itself up in 1978. At that time it had barely 130,000 individual businesses. Now it has several million, representing a large part of the economy. They are driving growth, creating jobs and contributing to social stability by absorbing workers from farms and SOEs. But not enough of them are growing into companies that can compete globally, developing proprietary technologies and long-term competitive advantages. Even with a level playing field, that would take decades. And they remain vulnerable. As the World Bank's strategy report notes: “The continued growth of the private sector cannot be taken for granted without continued progress in market reforms to improve the business environment.”

To continue to develop, China's private companies need, above all, rational banks and a well-functioning stockmarket. Yet if the private sector is China's brightest hope, the financial system is its weakest point.

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Inglorious riches

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It is still difficult to be wealthy in China

TO LOOK at him, it is not immediately obvious why Charles Zhang is considered one of China's most eligible bachelors. In his leather jacket and open-necked shirt, the 39-year-old appears disarmingly ordinary. Yet Mr Zhang is a celebrity in China. Not only does he run one of its best-known online portals, Sohu.com; he is also very rich and very proud of it.

More and more citizens of the world's last big communist country are coming out of the closet and declaring their wealth. In a nation that not so long ago hounded “capitalist roaders”, the concept of private enterprise is becoming accepted. Mr Zhang, echoing Deng's exhortation that “to get rich is glorious”, declares that it is “morally uplifting to be a wealth creator”.

When China's “rich list” was first published in 1999 by *Forbes*, an American magazine, Rupert Hoogewerf, the journalist who compiled it, was threatened by some of the people he wanted to include. Nowadays, businessmen complain when they are omitted. “It is becoming an honour to be on the list. It gives kudos with local governments and recognition overseas,” says Mr Hoogewerf. Indeed, rich lists have turned into a small business in their own right. Mr Hoogewerf has taken his contact book to *Chinamoney*, part of Britain's *Euromoney*, and *Forbes* is working on a rival tally.

The entry bar has gone up steeply in recent years. In 1999, all a candidate needed to make the list was $6m. By last year, the figure had risen to $110m. On average, the latest crop of China's rich are 44 years old and worth $230m. Their combined wealth of $23 billion is equivalent to 1.6% of GDP. Startlingly, a quarter are members of the Communist Party.

Even so, China's attitude to personal wealth remains deeply ambivalent. Splashing out on property, cars and entertainment still causes more jealousy than admiration. Locals have dubbed the ranking the “death list” because inclusion has often led to a jail term or worse for corruption or unpaid taxes.

The taint of corruption is hard to shed. Three-quarters of the top 100 made their money in property or at the head of sprawling conglomerates, reflecting the fact that the first generation of Chinese entrepreneurs used their government connections to grab state-owned assets at fire-sale prices. As Mr Zhang notes: “Illegal, shady business is the foundation of the first pots of gold.” True, the list now includes a few technology whizz-kids like him, but America's high-tech bubble showed that such firms can be transient. In terms of social acceptance and durability, China's private sector still has much to prove. The country's rich may enjoy many luxuries, but peace of mind is not one of them.

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Non-performing

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China's sclerotic financial system not only fails to allocate capital properly; its frailty endangers the country's continued growth and stability

AP

Still awaiting reform

IF MONEY circulates around a sound economy the way blood circulates around a healthy body, then outwardly robust China has a black hole for a heart. It is in the financial system that the contradictions inherent in Deng's “socialist market economy” are most apparent, with a banking sector that has built up a mountain of non-performing loans (NPLs) by lavishing cash on value-destroying state firms while starving deserving private borrowers; a moribund stockmarket incapable of properly allocating capital and creating long-term wealth; a tiny corporate-bond market; an insignificant venture-capital industry; and a government that is financing growth through a potentially unsustainable rise in public debt.

But at least China's leadership is beginning to take financial reform seriously. One indication is the rise of western-minded officials such as Liu Mingkang, head of the China Banking Regulatory Commission (CBRC), and Zhou Xiaochuan, governor of the People's Bank of China, the central bank. The top priority is the banking system, which still provides Chinese businesses with nine-tenths of their funding and whose total loans have ballooned to 145% of GDP. Thanks to years of politically motivated lending, the banks have bad debts of up to 4 trillion yuan.

Yet another bail-out of the four big state-owned lenders (which control 60% of all banking assets) is now under way, following two unsuccessful efforts in 1998 and 1999. The latest spring-clean deals with the banks individually, and adroitly uses some of China's vast stock of foreign-exchange reserves to boost their capital. Further steps will be needed, but by next year both China Construction Bank and Bank of China, the two least bad of the big four, should be in shape for an international stockmarket listing.

Yet this may be “too little, too soon”, in the words of Nicholas Lardy, an expert on China's financial system and a senior fellow at the Institute for International Economics in Washington, DC. He believes the money is both insufficient and being injected too early. “The banks should not get outside funds until they prove that they can operate on a commercial basis,” he argues. That is still years away. As appendages of government, China's banks are massive, bureaucratic and imbued with an intensely political culture. The big four alone had 1.4m employees and 116,000 branches at the end of 2001. Branch managers often have closer ties to local officials and businessmen than to their own bosses, which breeds corruption.

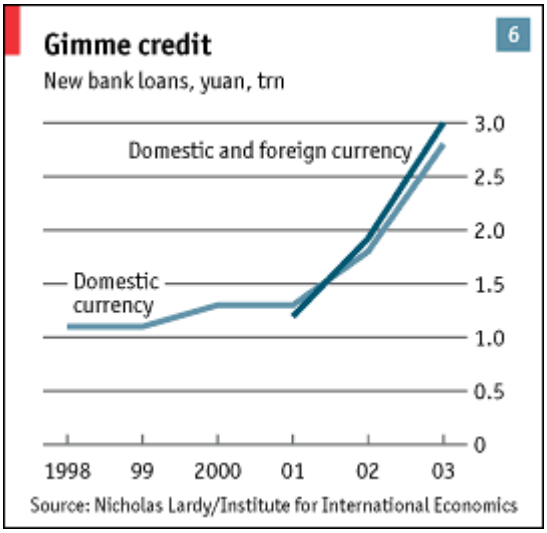
Javed Hamid, head of East Asia for the IFC, the private-sector lending arm of the World Bank, describes the state of affairs at the Bank of Shanghai, one of the better of the smaller city banks, when the IFC and HSBC took a stake in it in 2001: “The minutes of board meetings would be written before the meeting. Decisions would be made on the basis of [the bank's lending] growth, not whether it would improve

returns. Branch managers were like kings. They didn't know what a human-resources function was. People were rewarded not on the basis of market criteria, but on how loyal they were to the party."

Their master's voice

A look at the banks' recent behaviour shows that not much has changed. New lending took off in the fourth quarter of 2002 as the government tried to protect the economy from a world slowdown, creating 3 trillion yuan of new loans in 2003 (see chart 6), a 56% increase on the year before. In the final quarter of last year officials clamped down on lending, especially on property, to avoid overheating. Both the acceleration and the subsequent clampdown were directed from the centre. China's banks still carry out orders instead of applying commercial criteria.

Mr Liu at the CBRC is promising to improve top management, corporate governance and risk controls, not least by bringing in foreigners both as top managers and strategic shareholders. The central bank, for its part, has taken a step towards liberalising interest rates: since January this year, banks have been able to charge up to 70% more than the benchmark lending rate (rather than 30%), according to the riskiness of the borrower. But such reforms will take time to work through. And no one yet knows how many new NPLs have been created by the latest lending spree. Until that question has been answered, it will be difficult to attract foreign lenders as strategic partners.



If any western bank regards China as its territory, it is HSBC. But its Asia chairman, David Eldon, is sceptical about investing in institutions whose accounts he cannot trust and which, as things stand, he cannot control. "Once you own somewhere in excess of 20% but less than 30% [of a Chinese bank], you are putting your own balance sheet at risk," he says. The most likely investors in Chinese banks at present are global investment banks such as Citigroup and CSFB, which may take a stake in return for the lucrative mandate to underwrite their clients' initial public offering.

The investment banks have been making good money by helping to list Chinese companies internationally, and so have investors in these stocks: Hong Kong's H-share index of mainland companies doubled in 2003. This must be galling to domestic punters, who have seen the A-share markets in Shanghai and Shenzhen decline by around 30% since June 2001.

This performance reflects the sorry state of China's 14-year-old experiment with the stockmarket. Much of the decline can be attributed to a massive share overhang: the government still owns two-thirds of the equity in the country's 1,287 listed firms, and its periodic attempts to sell, or rumours that it may do so, depress prices. On top of that, the market is rigged by the securities industry, made up of 130 largely corrupt brokers, most of which are trying to stave off bankruptcy, having promised investors guaranteed returns they now cannot honour.

But the biggest problem is the poor quality of the listed companies. All but a handful are state enterprises, which are approved for an IPO by a political committee rather than by independent underwriters. A 2002 survey by the China Securities Regulatory Commission (CSRC), the top regulator, found that one in ten listed companies had doctored its books, and the finance ministry reported in January that 152 firms it had surveyed had mis-stated their profits by a combined 2.9 billion yuan. "The stockmarket has been used to support national industrial policy, to subsidise SOE restructuring, not to allow private companies to raise capital," says Stephen Green of the Royal Institute of International Affairs.

The CSRC is now trying to tackle one of the most serious abuses: shuffling assets between a listed company and its unlisted, state-owned parent to the disadvantage of minority shareholders. In future it will investigate "related party" transactions where companies buy or sell assets at a price that diverges more than 20% from an independent valuation. More spectacularly, the CSRC and the city government of Shenzhen in January seized control of China Southern Securities, the fifth-largest broker, because of corruption and mismanagement.

But in the government's eyes, stockmarket reform has a lower priority than salvaging the banks. This is partly because with a market capitalisation of around $500 billion, or 36% of GDP, the stockmarket is tiny (see chart 7), and its freely tradable part, $175 billion, even tinier; and ironically also because reform here harbours the greater danger: with somewhere between 5m and 15m active retail investors, concentrated in a few urban centres, new rules that depress prices further could create social unrest among those with most to lose.

Both the bad debts of the banking system and the stockmarket's failure to create a store of long-term wealth for the population have a bearing on China's public finances. Superficially these look in decent shape. At the end of 2002, the country's external public debt stood at a mere 7% of GDP, and domestic debt at a relatively modest 23%; but that is still more than triple the 1997 figure. To this must be added contingent liabilities: according to Mr Lardy, bailing out the entire banking system will cost a net 3.3 trillion yuan, or 30% of GDP, over the next few years. Setting up a proper public pension and welfare system will require another 70% of GDP or more, though over a longer time span. Still, on a conservative reading, China's liabilities amount to at least 60% of GDP.

At present, the country has no problem servicing these. Tax collection has improved from 12% to 18% of GDP over the past decade. More important, interest rates have been at historic lows, so in 2002 it took less than 5% of government spending to service the domestic debt. But what if the tax take declined again or rates went up? “There are serious questions over the country's fiscal sustainability,” says Mr Lardy. A financial crisis looks unlikely in the short term, but it cannot be discounted—and as a developing economy with a broken financial system, China remains susceptible to possible external shocks, such as a war with Taiwan. At the very least, the country will soon have to restrain its reckless fiscal pump-priming and will need to stop bankrolling SOE reform and rural migration.

That presages an economic slowdown, and slower growth is the one thing China's leaders are seriously afraid of. It carries with it the risk of massive job losses and social upheaval, recalling the days of the Tiananmen Square protests in 1989. Another such episode could force political change and even—however unimaginable at present—an end to the Communist Party's rule. And although few would regret the party's passing, for a while it would no doubt be bad for business.

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European business

Tested by the mighty euro

Mar 18th 2004
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European business is coping with the strong euro. For the moment

Get article background

A STRONG currency may be a central banker's dream, but it can be a nightmare for companies. If they export to countries with weakening currencies, their goods become less competitive while imports into their home market become more so. Export sales fade while repatriated profits count for less.

So, given that the great majority of European blue-chip firms are big exporters and that the euro has risen by some 50% against the dollar since its low in July 2001, why are European businessmen not depressed? France's business-confidence index has been rising since last June. Germany's IFO confidence index rose for nine consecutive months until a small blip in February. Only the Italians are gloomy, owing to their financial scandals.

European businesses have been able to cope with a strengthening euro because of strong global growth and their use of foreign investments and hedging to protect against currency risk. Many big European companies have produced decent results for 2003, as the pick-up in global activity compensated for currency losses.

The extent of each firm's currency woes also depends on where its exports go. Some big firms export mostly within the euro zone. Germany, France and Italy are each other's most important export markets. But companies with a global reach, such as German carmakers and French luxury-goods firms, are more vulnerable.

In addition to using financial derivatives for currency hedging, many firms have built “natural hedges” by moving some production abroad, at the expense of euro-zone output. DaimlerChrysler, for instance, produces all of its M-class Mercedes in Alabama, and so the weaker dollar has meant windfall profits on exports back to Europe. But, as the euro has risen, for most of its exported models Mercedes, like its rival BMW, has had to increase its prices in America.

Skidding alarmingly

Volkswagen, Europe's biggest carmaker, says that the strong euro shaved €1 billion ($1.25 billion) from profits last year, even though it makes some models in Mexico, which limits the damage. It recently reported a 62% fall in pre-tax profits to €1.5 billion in 2003. It is using the currency crunch as an excuse to cut 5,000 jobs that it needed to slash anyway from its over-manned German plants. Even Renault, PSA Peugeot Citroën and Opel (the German arm of General Motors), though they do not sell in America, are hit indirectly, says GM's boss, Rick Wagoner, as more cars intended for export are instead diverted to European markets, adding to over-supply there.

There are other indirect effects. Passenger aircraft are priced in dollars (like oil, see next story), so Airbus has to grit its teeth and can take only slight consolation from the $4 billion of parts it buys from America each year. Airbus's boss, Noël Forgeard, says, somewhat bombastically, that he will rely on the high margins from Airbus's new super-jumbo, on sale from 2006, as his ultimate hedge against the weak dollar.

Louis Vuitton Moët Hennessy (LVMH), a French luxury-goods firm, announced a 9% rise in operating profits earlier this month. If the euro had remained at its 2002 levels, the rise would have been 20%, says Patrick Houel, the group's finance director. All LVMH's production costs are in euros, while revenue splits three ways between euros, dollars and other currencies.

For DSM, a Dutch specialty-chemicals group, a one percentage-point move in the dollar exchange-rate has a €7m-11m impact on profits. About four-fifths of its sales are in dollars, but two-thirds of production is in the euro zone. For the moment, says the chairman, Peter Elverding, DSM's only hedge is to borrow in cheap dollars. The company may also move more of its production outside the euro zone. In 2000 it bought Catalytica, an American pharmaceuticals firm, partly in order to reduce its currency risk.

Across the board, European firms lost between 8-10% in revenue growth because of the weakness of the dollar last year, says Walter Kemmsies of J.P. Morgan. Even so, European firms have been lucky—in particular, the recovery of the capital-expenditure cycle is soothing the euro pain, says Joachim Fels, an economist at Morgan Stanley. The euro's appreciation coincided with rising demand for European goods. German exports to China, for instance, increased by 30% last year says Mr Fels.

But how long can this surprisingly happy situation continue? The latest numbers from the European Central Bank and Eurostat show the volume of exports of capital goods from the euro zone falling at an annual rate of 10.5% in the fourth quarter of last year, even as trade inside the euro zone grew. Meanwhile imports from outside the zone grew by almost 4% last year. By the end of 2003 the euro zone's import prices had fallen by 12% from their peak in November 2000.

In theory, the many disadvantages to European firms of the strong euro come with one notable advantage: they now enjoy greater purchasing power in the merger and acquisition markets of countries with weakening currencies. Yet, curiously, they have bought hardly any American businesses in the past two years, whereas American takeovers in the euro zone have been rising, according to Jimmy Elliott, head of North American mergers and acquisitions at J.P. Morgan. This suggests that exchange-rate opportunism is probably not, in fact, a big driver of merger activity—and, perhaps, that the global ambition, risk-appetite and balance sheets of American firms have recovered from their recent battering more quickly than those of their European counterparts.

Overall, though, few American firms have gained much from the strong euro because few of them are big exporters—although those that are have done nicely.

Last week McDonald's reported its 10th consecutive monthly sales gain, a shift attributed partly to the weaker dollar. Its European sales were up by 27% in February, but by only 9% in “constant currency” terms. The same is true for drugs firms, such as Merck, Pfizer, Bristol-Myers Squibb and Eli Lilly; all have big overseas sales, but incur manufacturing costs in euros.

Chinese firms are reaping the currency bonanza too, with the weakness of the dollar-pegged yuan spurring growing exports of Chinese goods (clothes, toys and cheap knick-knacks) into Europe. Euro-China trade used to balance, but last year, according to Allan Jianjun Zhang, director of the China Business Centre at PricewaterhouseCoopers, China enjoyed a surplus of more than $16 billion.

In their budgeting for the coming year, now reaching its conclusion, most European firms are assuming that the dollar will stay around $1.20 to the euro. But BMW, for one, thinks that the euro is now overvalued, and has stopped hedging against further falls in the dollar. On the other hand, plenty of European businessmen fear that the dollar has further to fall. Still, at today's exchange rate, the euro is

not much above the $1.17 at which it was launched in January 1999. Then nobody called the new-born currency too strong. In fact, many claimed it was too weak.

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The price of oil

Not so bad

Mar 18th 2004 | NEW YORK
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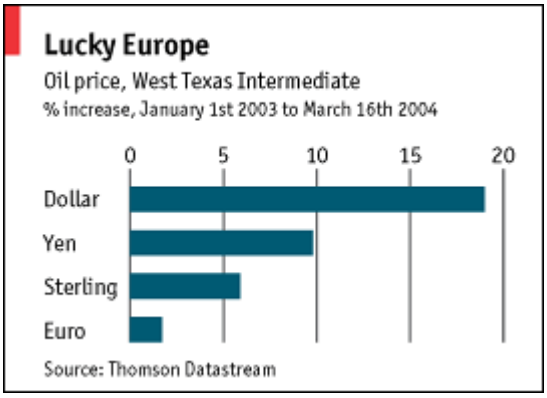
Are companies protesting too much about high oil prices?



"FOR the last 30 years, the price of oil has been the single most important determinant of the economy and the stock market." So claim the authors of "Oil Factor", one of a spate of gloomy new books about energy. They claim that the oil price will soar above $100 a barrel "by the end of the decade, and possibly sooner." Such a spike, they say, would drag the global economy into a severe recession.

You do not need to believe such scenarios (which rest on the dubious assumption of imminent oil scarcity) to be worried about the impact of oil prices today. After all, the OPEC cartel has kept prices above $30 a barrel for much of the past three years. In America, petrol prices at the retail pump are approaching all-time highs. Headlines on both sides of the Atlantic have proclaimed an energy crisis.

At least for some gas-guzzling industries, the fear seems justified. Airlines, for example, have been hit hard by the surge in the price of jet fuel. American, Delta and several others announced a temporary fuel surcharge of $10 per ticket to compensate, only to reverse it when rivals did not follow suit. The chemicals business is also vulnerable, as it uses hydrocarbons both as a feedstock and as a source of energy. Du Pont, the world's biggest chemicals firm, recently estimated that a $1 rise in the price of both oil and natural gas adds about $135m a year to its pre-tax costs.

But look beyond the most energy-intensive sectors, and the notion that high oil prices are quashing demand and wrecking firms is overdone. One reason: OECD economies are less energy-intensive than three decades ago when the first oil shocks occurred, thanks to the shift out of manufacturing into services and information technology. And, in real terms, even the current "high" oil price of over $38 a barrel is still below half its historic peak.

The story is further complicated by the recent plunge of the dollar, the only currency in which oil is traded. The relative strength of the euro and sterling have greatly reduced the pain of dollar-price increases for firms in Europe (see chart).

But what of other big oil-guzzling economies? "Americans might whine about it, but they aren't in pain because the oil price is $35," argues Roger Diwan of PFC Energy, a consultancy. As evidence, he points to the robust growth in demand for oil in America in recent months—one of the main reasons why prices are now so high.

The same is true of China, which has a currency peg to the dollar and is thus fully exposed to the rising oil price, and has also, like many other developing countries, become much more reliant on oil in recent years as their economies have moved from agriculture to heavy manufacturing. Higher prices have not dented Chinese demand. In fact, China has just passed Japan to become the world's second-largest oil consumer.

Certainly some firms in energy-intensive industries are in for a rough ride as OPEC tries to keep prices high through America's summer "driving season." But claims that today's oil prices amount to anything approaching a crisis for business at large are unfounded.

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BAE Systems

Changing the guard

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A new chairman for Britain's leading defence firm, but the same old threats

ANY day now BAE Systems (formerly British Aerospace) will announce the appointment of a new chairman to succeed the redoubtable Sir Richard Evans, who has dominated the company for ten years, even brutally ousting his chief executive and anointed successor two years ago while the poor man was on a ski holiday. The current favourite is Richard Olver, deputy chief executive of BP. Mr Olver was passed over for the top job there, but comes with a formidable reputation for project management, having delivered precisely the growth in production that has escaped its beleaguered rival Shell. Just as well, for BAE could do with a bit of help with its project management. (Another possibility is Richard Lapthorne, a former BAE finance director who now chairs Cable & Wireless.)

Incoming problems

BAE has delivered late and over budget on almost every project for years. Just as its wasted regional passenger-jet business brought it to the brink of bankruptcy in the early 1990s, so its contracts with Britain's Ministry of Defence have brought it little but grief during the past four years. The problems have multiplied since it acquired naval shipyards when it bought the GEC-Marconi defence business in 1999. From fighters to torpedoes, from submarines to reconnaissance planes, they are invariably tardy and over budget.

BAE's latest set of accounts was the first for many years not to be sullied with hundreds of millions of pounds in write-offs to cover the over-run disasters. One person with inside knowledge of the company claims that it has been losing money on nearly everything except the so-called Al Yamamah contract to supply and run Saudi Arabia's air force. That is a barter deal done via the Saudi and British governments, whereby BAE gets paid in oil. This deal produces nearly half of the company's profits, £411m ($700m) out of £980m last year.

BAE's accounts disguise this with a lot of waffle about its “customer solutions and support” division. But that is essentially the long-running Saudi deal, which came BAE's way nearly 20 years ago because the then members of Congress would not allow American contractors to supply a potential enemy of Israel.

With oil now at its highest sustained price level since 1983, this deal should be providing a fat cash cushion behind which BAE could stuff lots of other losses this year. Unfortunately, the strength of sterling against the dollar is partly dissipating the windfall gain. BAE's other two money-spinners are its one-fifth stake in Airbus and its North American subsidiaries. Despite the biggest ever slump in the passenger-jet

market and the $1 billion-a-year cost of developing its A380 super-jumbo, Airbus accounts for more than 20% of BAE's profits. BAE North America is a supplier to big American defence contractors.

Paolo Scaroni, boss of Enel, an Italian energy firm, and a highly respected European businessman, is quitting BAE's board in May. He is disgusted with BAE under its chief executive, Mike Turner, an aggressive marketer who played a big part in the success of Airbus. Mr Scaroni thinks the board should have addressed his detailed concerns about poor project management and ongoing losses instead of constantly chewing over how to escape its woes by leaping into the arms of an American defence contractor (ideally Boeing). America matters because it accounts for half of the current world market for defence equipment.

BAE's American expansion plans are in trouble for two reasons. In 2002 it was outbid by Northrop Grumman for TRW, a leading American defence contractor and car-parts maker that had put itself up for sale. If BAE had acquired TRW, it would have moved up into a higher league in America by becoming a prime contractor to the Pentagon.

After losing TRW, BAE started talks with existing American prime contractors about merging with them. Unfortunately the likes of Boeing and General Dynamics were not interested. General Dynamics, which shares the armoured-vehicle market in America with United Defense, has even parked its tanks on BAE's lawn in a different way: it is considering bidding for Alvis, a British armoured-vehicle and tank manufacturer in which BAE has a 29% stake. BAE is still debating how to react.

The task for the incoming chairman, whoever he is, will be to assess quickly how much of BAE's weakness is really due to inept project management rather than to the British government's approach to defence procurement during the past 20 years. Mr Turner claims that Britain's fixed-price system for both the development and production of new weapons is the real culprit, leading BAE to pile up losses while the perennially indecisive Ministry of Defence changes its requirements, which sends costs out of control. The truth? To be fair, probably quite a lot of both.

Mr Turner now thinks he has persuaded the British government to adopt a system more like America's, whereby development risks are borne by government via cost-plus contracts, with fixed-price contracts used only for actual production deals. But Mr Turner's monopsonist customer is increasingly interested in buying from other members of the global defence oligopoly, rather than supporting a national champion as other European countries do. So BAE is having to share the contract to build two new aircraft carriers for the Royal Navy with Thales, a French defence company that wisely hired the ministry of defence's crack naval-design team when it was privatised. Meanwhile Mr Turner is cannily refusing to sign a definitive carrier deal until the development cost is known. Nothing is ever simple in the pork-barrel business of defence.

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Business in Mexico

Still keeping it in the family

Mar 18th 2004 | MEXICO CITY
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The family business model not only survives in Mexico, it prospers

“YOU trust your blood, and that's it,” is one Mexican's summary of the advantages of family-owned businesses. But then his blood has served him well. Gregorio Chedraui happens to be a scion of one of the country's most successful business families. Originally migrants from Lebanon at the turn of the last century, the Chedrauis possess a portfolio of interests ranging from retailing to road haulage.

Mr Chedraui's wealth and success make him exceptional in one way, but in another, very Mexican way, quite ordinary. It is estimated that up to 95% of Mexican businesses are still wholly family-owned and run. Indeed, 43% of the value of the Mexican stockmarket is in firms controlled by just one family, that of Carlos Slim (see article). So high an incidence of family-owned businesses is also typically Latin American. In Europe, say, only around 80% of firms are family owned.

Whether this is a good thing for Latin American economies is another matter. For, at first sight, the continuing popularity of family businesses can seem surprising. There is now lots of evidence that they have been greatly out-performed in the region by other forms of business organisations. Research by McKinsey, a management consultancy, indicates that in the final five years of the booming 1990s, the share of family-owned businesses in the ranks of the top 100 Latin American companies, measured by revenues, fell noticeably in countries such as Argentina and Venezuela. But the change was even more dramatic in Mexico, one of the region's economic success-stories, where it fell much more sharply, from 71% to 57%. This was due to the opening up of the economy and greater deregulation which allowed multinationals to take a greater market share, partly by buying local family firms.

According to standard business-school theory, this apparent triumph of the modern, professional, publicly-traded firm is only to be expected. After all, are not family businesses over-cautious, amateurish and prone to destabilising family squabbles? As the old adage puts it: the first generation builds the company, the second lets it stagnate, and the third squanders it.

So why do Mexicans, like other Latin Americans, still place such faith in the family-business model? Family firms, as Mr Chedraui suggests, are all about trust—or, rather, the lack of it in any institution other than the family. This may be a matter of temperament. Antonio Chedraui, the head of the family and owner of Grupo Tony, based in the port city of Veracruz, asserts that “we are Latins, we don't trust anyone”. But he also argues persuasively that Mexican businessmen have become used to operating in an environment in which, at one time or another, almost every other institution, from the banks, to the regulators, to the police, to the government has proved to be corrupt, often extremely so.

In the end, empirically, the family remains, by these standards, a relatively safe environment in which to work and invest. Until Latin Americans have more faith in the integrity of all their institutions, financial and governmental, then the family-business will remain a cornerstone of the region's economies. As Imanol Belausteguigoitia, a professor at Mexico City's ITAM University, says, “in this region we are in permanent crisis, and family businesses bring stability”.

But Mr Belausteguigoitia, who heads a research unit on family-businesses, also argues that family businesses can enjoy other innate advantages. Not having to deliver endlessly improving quarterly results, they tend to be more stable and to “have a long-term vision”. They may grow slowly, but they grow more solidly. And, they are close to local markets, and accumulate the sort of intimate knowledge of local tastes and customs that no multinational can match.

As well as Mr Slim's, Mexico now boasts several very successful family-run firms, including Bimbo, a food company, and Modelo, a brewer best known for its Corona beer. After first consolidating a core customer-

base in Mexico, these firms are now expanding overseas.

Today Mexican business schools are catering to a rising demand for courses specifically focusing on the problems and challenges of the family-businesses. Mr Belausteguigoitia, who runs one of them, argues that, ultimately, “it is not about being family or non-family; it is about being professional or not professional”.

So an increasing number of younger family members are enrolling on courses to learn about conflict resolution in the family, or the problems of “familism” (having too many useless family members on the company payroll). Success in many family businesses, it seems, is no longer just being left to the genes.

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A deal in Brazil

Slim pickings

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Carlos Slim moves closer to dominating Latin America's telecom industry

THE $360m deal to buy a controlling stake in Embratel, Brazil's biggest long-distance operator, announced on March 16th, is an important step for Latin America's richest tycoon. Carlos Slim, owner of Telmex, Mexico's main telecom firm, and of América Móvil, its biggest cellular operator, has plenty of cash and a yearning to expand beyond his stagnant home market.

He has found his outlet in a relentless expansion across Latin America. Telmex recently bought AT&T Latin America for $207m, allowing it to penetrate the Chilean, Peruvian and Colombian markets. América Móvil is already the region's biggest cellular operator and has the second-largest share of Brazil's market. Embratel will raise Mr Slim's revenues in Brazil to 11.5 billion *reais* ($4 billion) making him the third-biggest player overall, with leading shares of the long-distance and data markets.

Embratel's main businesses—long distance and data—face fierce competition, however. Recently, it has improved its results by cutting costs and reducing bad debt. Even so, combined, Mr Slim's Brazilian operations would be roughly half as profitable as those of the three local-telephony monopolies, reckons Sílvio Genesini of Accenture. To narrow the gap, Mr Slim is likely to offer mobile-telephony services to Embratel's corporate customers. He will also do more with Embratel's small local-telephony business, though this will be a harder market to penetrate. There has been speculation that Mr Slim will next bid for Telemar, one of the three big fixed-line monopolies.

The Embratel deal would not by itself disrupt the competitive balance of power in Brazil, where it fights the three regional monopolies for the long-distance market. The other main bid, had it succeeded, would have done.

It was driven by a consortium of these three main rivals, one of which is also Telmex's main rival for Latin American supremacy, Telefónica of Spain. The consortium offered $190m more than Mr Slim for the controlling stake. But there were good reasons to take the lower offer. Brazilian regulators might well have rejected the takeover of the main long-distance firm by three big competitors. The seller, MCI (formerly scandal-hit WorldCom) wanted an immediate sale to raise cash to help it escape bankruptcy, not slow regulatory torture. But the disappointed bidders are expected to challenge the sale before the American court handling MCI's bankruptcy.

With the Embratel deal, Mr Slim has “lived up to his reputation for buying assets on the cheap,” says Josh Milberg, an analyst at ING. Because many shares in Embratel are the non-voting preference sort, he was able to gain control by buying only around one-fifth of its total equity. (He must still offer to buy the rest of the non-voting shares.) The price of voting shares dropped by 25% on news of the sale; investors had expected a better deal. But holders of preference shares, often an abused majority in Brazil, expect Mr Slim to push up profits. And, if they are lucky, Mr Slim will use another chunk of his cash to buy them out.

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Chinese business

Haier's purpose

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Haier shows why China will struggle to build a global brand

A NEW name has found its way on to the billboards that decorate the world's most expensive cities. Alongside Toshiba and General Electric, the neon lights in downtown Tokyo and Milan now flash: Haier. On the face of it, China's leading maker of fridges, washing machines and air-conditioners looks like a global success. Haier has factories and offices in more than 100 countries, a $15m American headquarters in mid-town Manhattan and a cult following among American college students who chill their beer in its mini-fridges, sold at Wal-Mart. And Haier is gearing up to become even more global. This week it emerged that the firm will soon inject core mainland assets into a small listed firm in Hong Kong to give it a paper currency for overseas acquisitions.

Haier is lionised in the foreign press too. *Fortune* rated its boss, Zhang Ruimin, one of the 25 most powerful business people outside America. The *Far Eastern Economic Review* and the *Financial Times* each crowned Haier as China's most respected company. The firm has risen from nowhere: its sales, 80 billion yuan ($9.7 billion) in 2003, have grown by 70% a year on average over the past two decades.

Proud Chinese cite such worldwide attention as proof that their country can build global brands every bit as good as American, Japanese and South Korean ones. Mr Zhang's capitalist style of management—inspired by ex-GE boss Jack Welch—is legendary. And yet for all the accolades, the firm also suffers from serious weaknesses which could take a heavy toll.

In 1984, Mr Zhang, then a minor bureaucrat in Qingdao, a port city south of Beijing, took control of a loss-making refrigerator firm. He inherited an organisation with workers so ill-disciplined that they got drunk and urinated on the factory floor. To deliver a shock, Mr Zhang ordered his workers to smash 76 faulty fridges from the stockroom, laying into the first himself with a sledgehammer—now preserved for its symbolism in Haier's museum. Mr Zhang then introduced strict rewards and punishments. In homage to the “struggle sessions” of the Cultural Revolution, he made errant workers stand on red footprints painted on the factory floor and publicly confess their failings.

Such discipline made Haier profitable within a year. By 1991 it was market leader in China and Mr Zhang had expanded beyond fridges into a range of white goods by taking over other moribund state enterprises. Today he is an alternate member of the Communist Party Central Committee—a rare honour for a businessman. Haier's factory sheds cover more than a square kilometre of Qingdao. Haier is the leading seller in China of most home appliances, with market shares of 20-70%.

What will be will be

From such a strong base, international expansion must seem logical and inevitable. Haier is by no means the only Chinese firm eyeing up the rest of the world. But while the big oil and commodity producers are buying resources overseas and most mainland manufacturers are content to sell their goods under foreign firms' labels, Haier is trying something much harder: to create a genuine global brand.

It has had some success. Its overseas sales are currently $1 billion. Haier claims 30% of the market for small fridges and half the market for wine coolers in America, and a tenth of Europe's air-conditioner market. Haier is now the world's fourth-largest white-goods maker behind Whirlpool, Electrolux and Bosch-Siemens and ahead of GE—though that is mostly owing to its big domestic production volumes. Mr Zhang wants to be number three.

But size does not automatically mean quality, just as buying name recognition at any price (that

Manhattan HQ) does not equal careful brand-building. Haier's drive into markets abroad mirrors a push into new markets at home. In both, diversification is driven by opportunism and desperation, not good strategy. Predicting that profits in 2004 will be flat at 2 billion yuan for a third successive year, despite an expected 20-30% rise in sales, Mr Zhang admits that plunging returns in his core white goods business are driving him abroad. After China joined the World Trade Organisation, he says, “every multinational set up in China. Margins are low here. If we don't go outside, we cannot survive.”

Outside China, Haier has so far concentrated on niches—mini-fridges (to which it adds a handy fold-down flap for a laptop) and wine coolers. But to continue to grow globally it will have to compete with the likes of Whirlpool in their main markets. Yet Haier lacks such firm's R&D, their design skills—it employs just ten researchers in America—their distribution or their service networks. Mr Zhang says his biggest headache is hiring decent managers, since he cannot pay as well as rivals. Haier does not have their established brands—or the money to build one.

Nor is Haier being careful to keep costs low. Mr Zhang insists that Haier must produce outside China to be responsive to customers. Yet, at a stroke, that deprives Haier of its greatest advantage: China's vast pool of low-cost labour. Meanwhile, Haier's attempt to reward creativity—allowing every engineer the freedom to design and build his own products—has worked too well, leaving it with a bewildering 96 categories of goods in 15,100 specifications, including a fridge that pickles Korean *kimchee* cabbage and a washing machine that also cleans sweet potatoes. Most of these variants add more to production costs and complexity than they will ever add to sales. Worse, the group has moved beyond white goods into computers, mobile phones (where sales have badly disappointed), and even interior design and pharmaceuticals. All with unlimited potential, insists Mr Zhang. “This is a globalised era. No single industry can survive. There is a great future in these markets.”

This attitude is widespread in China. Rather than focusing on a core business or dominating a few markets, as western, Japanese and South Korean managers have slowly learned to do, their Chinese counterparts quit any market where competition is rising, as so many other profitable opportunities beckon. Lack of accountability—not even Mr Zhang can say who really owns Haier—and cheap loans from state banks encourage this trend. The result is firms that are broad but shallow, thinly-spread and managerially stretched. Sadly for Haier, that is the very opposite of a focused, global brand.

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Face value

Where's the lawyer?

Mar 18th 2004
From The Economist print edition

Nowadays every firm should have its own in-house lawyer-statesman, says Ben Heineman

"IT IS the best of times for general counsels and it is the worst of times." So paraphrases Ben Heineman, who has just given up the title of general counsel—though not necessarily the influence that came with it—at General Electric after nearly 17 years in which he became arguably the world's most admired in-house corporate lawyer and, it is said, its highest paid. He will remain at GE as "senior vice-president, law and public affairs".

For the worst of times, look no further than the recent ethical crisis in corporate America. As Mr Heineman reminded the "in-house bar" at last week's General Counsel Roundtable hosted by *The Economist* and *Corporate Board Member*, some general counsels have been indicted and others accused of heading departments where there is credible evidence of malpractice and breach of fiduciary duties. Still others, he observed, are now "haunted by the question 'where were they?' as their enterprises literally collapsed in internal fraud and corruption".

The best of times are not so obvious. Mr Heineman believes that the woes of corporate America have created an opportunity, and a pressing need, for general counsels to carry out the "rather grandiloquently named role of 'lawyer-statesman' or 'statesman-adviser'." He has in mind a sort of *éminence grise* function, the corporate equivalent of Père Joseph to Cardinal Richelieu, instead of the narrow, technical lawyer that was too often the general counsel of recent years—though not, ahem, at GE.

The ideal of the lawyer-statesman first emerged after the second world war, along with the big modern corporation. Among his skills, the lawyer-statesman would supply practical wisdom, not just technical mastery; an understanding of long-term effects, not just how to achieve short-term advantage; and a deep concern (or, at least, the appearance of it) for the public interest as well as for the private good of his client. In those golden days, the lawyer-statesman was not in-house but, rather, a senior partner in a top private law firm, who provided counsel to top corporate clients as well as occasionally becoming a real statesman. Mr Heineman cites Cyrus Vance, secretary of state under Jimmy Carter, and James Baker, who did the same job under the first President George Bush—as well as helping to install the second with his legal strategy in Florida. In private practice, both men advised many corporate chiefs.

Long before the Enron scandal, the decline of the lawyer-statesman was being regretted in books such as "The Lost Lawyer", by Tony Kronman, a dean of Yale Law School, and "The Betrayed Profession", by Sol Linowitz, a former general counsel (and chairman) of Xerox. Among the reasons suggested for the decline were the growing specialisation of law firms, reducing their ability to offer a broad view; a greater emphasis on profit by these firms; and the use of competitive bidding by companies buying legal services. "A senior partner is more likely to be bidding for work than whispering in the ear of the CEO," says Mr Heineman. GE recently increased such pressure by making law firms compete for its legal business in online auctions.

Though, says Mr Heineman, a few lawyer-statesmen remain in private practice, in future they are more likely to thrive inside companies. This view is controversial. After all, the pressure to compromise bearing down on an in-house lawyer from his sole client, in practice the chief executive, may be even harder to resist than that facing a private law firm, which can at least compete for work from many clients. Crucially, says Mr Heineman, the chief executive must "want, really want, unvarnished views" and the general counsel must be strong enough to give them, and to resign if they are not accepted.

And the role of in-house *éminence grise* may simply be impossibly demanding. Consider Mr Heineman's efforts to guide his long-time Cardinal Richelieu, Jack Welch, GE's former boss. If Mr Heineman gave Mr Welch unvarnished views about the obvious antitrust risks in Europe surrounding GE's planned acquisition of Honeywell, they went expensively unheeded. Nor did he succeed in preventing an embarrassing row about Mr Welch's perks in retirement, nor curb his enthusiasm for a compliant board or for smoothing GE's profits to keep investors sweet. On the other hand, he was impressively statesmanlike in quickly getting a grip when GE's record came under post-Enron scrutiny. He presided over a rapid, sweeping reform of the firm's corporate governance and executive pay that has won praise.

Trust me, I'm a lawyer-statesman

Some general counsels may feel that they have their work cut out just doing the narrow legal bits of their job. With new duties under the Sarbanes-Oxley act, greedy trial lawyers to the left of them and assorted government regulators and prosecutors to the right, surely they should spend every waking moment ensuring that their firm does not break the law? Besides, especially with pressure growing from regulators for the general counsel to act as a sort of in-house cop, is it really possible to be both an independent counsellor and a business partner, a lawyer and a member of the management team?

Mr Heineman thinks it is not only possible, but essential. The general counsel should be involved in everything from creating a “culture of compliance and integrity” to engaging in public debate and fighting the current cynicism about business. Making a “fair-minded and fair-sounding case for necessary public positions in our bitter political culture must be a core competency” of the general counsel, he says. GE is leading by example in one of the bitterest debates now gripping America. Its current boss, Jeff Immelt, has bravely spoken out in favour of outsourcing jobs abroad, although he has also said that he is reluctant to “become a poster child for this”. In the interests of free trade, if nothing else, here's hoping that lawyer-statesmen at other firms will persuade their bosses to follow suit.

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Non-executive directors

Where's all the fun gone?

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Non-executive directors are more independent and harder working than before. That is no guarantee that they can do a better job

AS RECENT power struggles at Shell and Hollinger International have amply shown, well-organised and determined non-executive directors can be a powerful force to improve corporate governance by reining in over-mighty chief executives. In most rich countries, efforts are under way to make that force more reliable. Better governance, it is argued, comes from making non-executive directors more independent and giving them more work to do. But actually, that is only part of the answer—and has drawbacks. Much the most important change is to find ways of encouraging non-executive directors to behave independently. And that, perhaps surprisingly, turns out to be easier than it sounds.

Jobs for the boys

Being a non-executive director—as opposed to a board member who is also part of the company's management—used to be a lovely job for distinguished folk with a little time to spare. A retired chief executive, a politician whose career had run out of steam, a lawyer: a seat on a company board was a way to boost earnings and earn modest distinction. That cosiness changed with Enron: in the intervening years, regulators in most rich countries have placed new demands on directors. Directors themselves are more aware of the risk to their reputation. And, by common consent, the mood on boards is different. Non-executive directors take their task more seriously than ever before.

Of course, that is not true everywhere. The scandal at Parmalat is a reminder that there are still large companies in developed countries where the old regime has survived. The company's board bulged with members of the Tanzi family and bigwigs from Parma. The company opted out of a law that demands that listed Italian companies have independent directors on the board. Before the scandal broke in December, Parmalat's practices had put it at the bottom of Italian peers in a governance rating issued by Institutional Shareholder Services, a group that promotes good governance.

Tighter laws, properly enforced, will stop chief executives packing their boards with their chums and putting insiders in sensitive spots such as the chair of the audit or remuneration committees. But increasingly the focus is on what happens once governance reforms have been implemented. Will company boards really be more independent? And will companies be better run as a result?

Undoubtedly, one impact of the tougher post-Enron environment has been to make boards take their

duties more seriously. They are meeting for longer and digging much deeper. Directors have begun to demand better information, and companies are starting to provide it. This is not always a boon: directors find themselves with vast piles of reading matter, but say plaintively that, if they asked for less, they might miss something important.

One result of this more serious approach is that directors put in longer hours. “Does it take time? You bet it takes time,” says Bill George, a recently retired chief executive. “It's complex to run a big company.” Korn/Ferry International, a firm of headhunters, regularly surveys directors of big companies. Its latest report found that the time they said they spent each month on board matters, including preparation time, attending meetings and travel, had risen from 13 hours in 2001 to 19 last year. British outside directors claim to spend even longer on the job: a hefty 25 hours a month.

Where does the time go? According to a recent survey of 249 directors of Fortune 1000 companies by Mercer Delta Consulting and the University of Southern California, 60% said they spent more time on board matters in 2003, with 85% spending more time on their company's accounts, 83% more on governance practices and 51% on monitoring financial performance.

There are other signs of their increasingly serious intent, as in a study of 300 or so large companies in Canada by Patrick O'Callaghan & Associates and Korn/Ferry. It found that 80% of boards had governance committees in 2002, as opposed to 69% in 2001; 49% of companies detailed non-audit fees paid to external auditors, up from 24%; 72% of firms include shares in directors' pay; 95% have only independent directors on their audit committees, up from 89%; and 89% have only independents on their compensation committees, up from 77%.

For some boardroom veterans, all this comes as a shock. Lots of older directors, observes Jeffrey Sonnenfeld of Yale University's School of Management, “are bewildered if not resentful” about the time now devoted to corporate governance.

Others are setting up offices to help them cope with the pressure. Betsy Atkins, a venture capitalist and professional director who sat briefly on the board of HealthSouth before that troubled company's woes became fully apparent, employs a staff of four, including two qualified accountants and a market researcher. Consultancy and law firms are eager to help other directors with their burdens.

One reason directors take their duties more seriously is that they have begun to realise the perils of getting it wrong. Ms Atkins abruptly left the board of HealthSouth because it became clear that the unrolling scandal there meant that her Directors' and Officers' (D&O) liability insurance had become invalid. Plenty of directors of more solid companies may be in that situation already without realising it, says Ralph Ferrara of Debevoise & Plimpton, an American law firm. He makes directors' flesh creep by saying to them, “If you can't get $100m of non-rescindable independent-director liability coverage, you shouldn't be on the board.” Practically nobody, he adds glumly, can get such cover. This will not surprise the independent directors of Equitable Life in Britain—they are being sued for up to £3 billion ($5.4 billion) for apparently failing to question the chief executive's reckless policies.

Who's in charge?

A more serious approach to the job is not the only change. Boardroom committees and their chairmen now have more power, and especially the big three: the audit, nominating and compensation committees. Chart 1 shows how American directors themselves think they are doing.

The main burden of monitoring management more closely falls everywhere on the audit committee. In some American companies this committee, rather than the chief financial officer (CFO), now hires and fires the external auditors—and pays them too at the best companies (though out of company funds, of course). Auditors agree that this makes it easier to do a tough audit: management is more hesitant about pushing them to make fine judgments on awkward issues. But the strengthening of the audit committee, if done clumsily, can send a hostile signal to executives: that the board thinks managers may misbehave.

The audit committee has more power, but it also has a larger workload. In 1999, says Korn/Ferry, the typical audit committee of a big American company met four times a year; now it meets five times, and has a growing number of telephone meetings too. The meetings are longer; the piles of papers to be read in advance are higher.

Another problem is that audit committees are evolving into mini-boards. As a result, the respective roles of the audit committee and the main board may become confused. There is, says Sue Frieden of Ernst & Young, a new triangle: auditors still have to work with management to get the information they need, but they now report to the audit committee. Jay Lorsch, a Harvard Business School professor who sits on, or advises, several boards, argues that one of the principal duties of the audit committee and its chairman is the management of these delicate relationships.

The nominating (or governance) committee also has more sway. Five years ago, says Dennis Carey of Spencer Stuart, another firm of headhunters, the chief executive was the client for 95% of the searches that his company conducted for outside directors. The nominating committee was a rubber stamp. Now, he says, the nominating committee is the client in over half of cases. Other search consultants report that the nominating committee increasingly signs the search firm's invoices and conducts at least the first round of interviews.

A key perk of the boss—controlling membership of the board—is thus slipping into the hands of independent directors instead. Quite right too, says Nell Minow, a campaigner for better corporate governance, who warns would-be directors to beware of being hired by the chief executive if they want to be considered truly independent. “If the CEO makes the phone call, you've got a problem,” she says.

The compensation or remuneration committee has also gained in stature. Some, such as Charles King of Korn/Ferry, even argue that these committees will soon have a higher profile than the audit committee. The reason is that executive compensation has become a hugely sensitive issue. Shareholders now want to see a selection of chief executives of other companies, active or retired, sitting on the compensation committee, combining an ability to understand immensely complex compensation schemes with a sense of what it is both reasonable and sensible to offer. Boards do not yet seem to be deliberately trying to recruit the human-resources directors of other companies as outside directors, but that surely cannot be far off.

State of independence

A third trend has been to bring in a larger proportion of outside directors. Typically, the board of a big American company now has nine outside and two inside directors—the latter being probably the chief executive and the CFO. More important is the enormous emphasis now put on the independence of

outside directors. Whereas they might once have been corporate suppliers, bankers or customers, today big companies try vigorously to avoid recruiting anybody who could conceivably have a conflict of interest.

The idea of directors' independence is not without controversy. Independence is a vague concept and defining it has proved difficult. In a recent policy statement, TIAA/CREF, a big activist-minded pension fund, says that independence means:

> no present or former employment by the company or any significant financial or personal tie to the company or its management that could compromise the director's objectivity and loyalty to the shareholders. An independent director does not regularly perform services for the company, if a disinterested observer would consider the relationship material. It does not matter if the service is performed individually or as a representative of an organization that is a professional adviser, consultant, or legal counsel to the company.

Some corporate-governance lobbyists want such people to make up the totality of non-executives on company boards or, as in the case of TIAA/CREF, a “substantial majority”. Others are content that they should merely account for more than half.

The question of independence is already a murky one in legal circles. Last year a Delaware court controversially ruled that a shareholder lawsuit against Oracle, a software firm, could proceed because a special committee formed to approve the sale of some shares by Oracle's boss had not been sufficiently independent. That sent corporate lawyers into a flurry of activity, warning clients to be more wary.

Finding independent directors is tough, but the increasing demands on their time are making them ever harder to recruit. Companies are proving more reluctant to commit their executives' time. Some big companies, for example, forbid their senior executives to take on more than one directorship. One reason for caution is that a crisis or takeover bid at the other company can embroil the outside directors in even more hours of time devoted to non-executive responsibilities. Another is the risk of embarrassment: the board of company A does not want to squirm just because its chief executive sits on the board of company B which has hit trouble.

The effect has been to start changing the composition of boards. Search consultants now approach humbler mortals: CFOs, general counsels and chief operating officers. The need to find financial expertise to chair the audit committee has sparked a boom in demand for CFOs and for retired partners of auditing firms. Three years ago, 10% of Korn/Ferry's searches were for financial talent; now, 60% of them are.

A big worry is that ignorance may be the price of independence. Directors may know how to read a company's financial statement, says Harvard's Mr Lorsch, but because they do not know the business, they may hesitate to discuss the equally important issue of strategy. “They don't talk enough about competitors, new products, the health of the business, what customers think of us,” he grumbles. Last year he published a book with Colin Carter, a consultant with the Boston Consulting Group (BCG), setting out his concerns.*

Certainly, in the few days a year that even the most energetic non-executive can devote, it is hard to learn much about the workings of a large and complex organisation. And few companies have well-structured induction programmes, mainly because new directors tend to trickle in one at a time, making education costly.

Of course, some directors can learn too much and start to go native. This is a particular risk for directors on the audit committee, says Ernst & Young's Ms Frieden. They need to maintain their independence, but they also need to develop a deep understanding of the company's financial statement, the business risk and the level of financial controls—but without second-guessing management.

BCG's Mr Carter has a more subtle fear. If directors are known to be technically independent, others may assume that they are also effectively independent. Yet the two do not necessarily go together. On plenty of boards made up of old chums, a cosy culture can lull directors' inquisitiveness. Sir Adrian Cadbury, the architect of Britain's system of corporate governance, points to the board of Shell that took the wrong decision on disposing of a large oil platform in the North Sea. “They all saw things the same way,” he says. “You only need one person to ask the right question.”

Executive-free zones

By common consent, independence is an attitude of mind, rather than a list of business credentials. A fourth innovation has, more than any other, helped boards to develop this attitude. It is what Americans confusingly call “executive session”. This is a regular meeting, required under the new listing rules of the New York Stock Exchange, of the board's non-executive directors without the presence of the management or of the chief executive. As chart 2 shows, it occurs mainly in America.

The rise of the executive session is, says Mr Lorsch, “absolutely the most important thing that's happened”. Meeting without their powerful boss, directors are initially rather awkward, he reports. Then they begin to talk: about the most recent board meeting, about a manager whose presentation seemed inarticulate, sometimes even about the chief executive's strengths. This can provide a golden opportunity to broach delicate subjects such as evaluating the chief executive's performance or even the touchiest question of all: his succession. There is also a change in the tone of discussions back in the boardroom. Directors grow bolder and more willing to argue with the chief executive, knowing where others share their doubts.

But the effectiveness of executive sessions cannot disguise the unresolved questions in the boardroom. How independent ought directors to be? And how to ensure that they are? The OECD, a Paris-based international organisation, is drawing up corporate-governance guidelines for its rich-country members. Among other effects, these will give shareholders more control over the selection process. America's Securities and Exchange Commission is aiming at the same goal with a proposal to make it easier for big shareholders to nominate board members. OECD officials argue that American shareholders are less powerful than those in Australia, Britain and Canada, who have, for example, the power to turf out an entire board at their own initiative. Other members worry that enhanced shareholder power may be abused: used, for instance, by a big investor to win a boardroom seat and promote his own interests, rather than those of all shareholders equally.

And the emphasis on independence deepens the contrast between what happens on the boards of publicly quoted companies and of the many businesses now owned and run by private equity or venture capital. There, directors are hands-on and interventionist, rather than independent and carefully distant. Public companies are increasingly governed by people chosen because they know nothing about the business; privately owned companies are the reverse.

One solution, suggested by Messrs Carter and Lorsch, might be to promote a third category of director on the boards of public companies: the non-independent non-executive. A few people who know the business well but don't work for it would improve strategic discussions, and they could always leave the room when conflicts of interest arose. Moreover, provided they were genuinely selected for their independence of mind and judgment, shareholders might feel they were being better served than by the alternative: people who tick the right boxes, but ask the wrong questions.

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* “Back to the Drawing Board”, by Colin Carter and Jay Lorsch. Harvard Business School Press, 2003.

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Financial markets

A question of perspective

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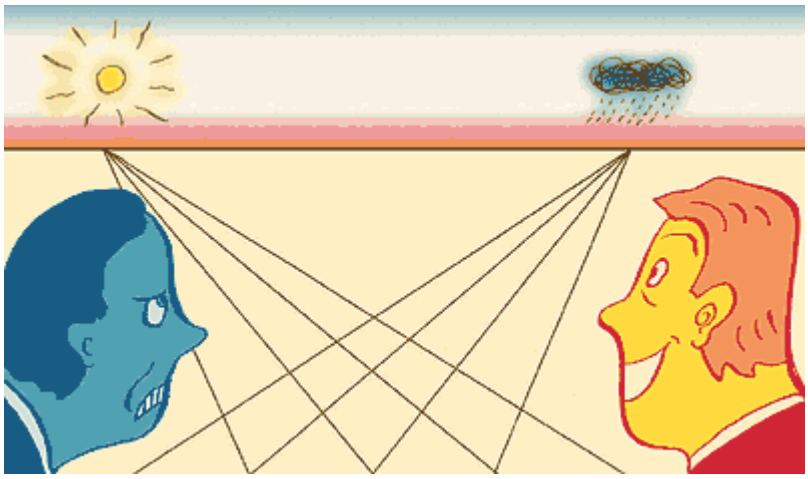
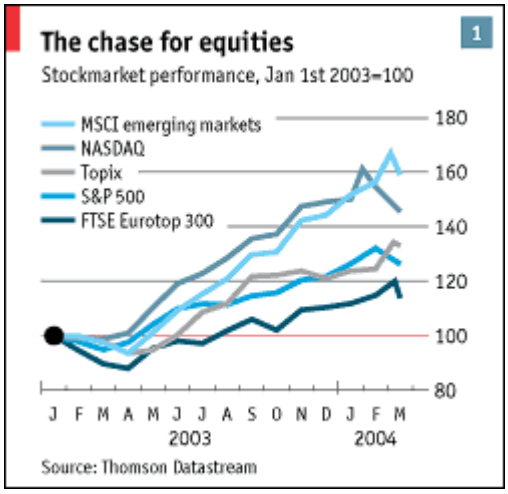


The outlook brightens for government bonds and darkens for riskier assets

TO NO one's surprise, America's Federal Reserve left short-term interest rates at a 46-year low of 1% on March 16th, again with heavy hints that they would stay there a while. Perhaps, indeed, for longer than many had thought: output, previously described as “expanding briskly” is now merely growing “at a solid pace”; and the Fed gave a nod to the weak jobs market that it had not given before. Some economists now think that rates will not be raised until the middle of next year.

Ultra-low interest rates pose a huge problem for investors and ultimately for the Fed itself. The central bank's stance has encouraged punters to take risks on an unprecedented scale. America's rock-bottom interest rates have unleashed a flood of money into risky assets the world over. Since late 2002 everything from rich-country shares to emerging-market bonds have soared as American investors, who save almost nothing, have sought better returns than the desultory ones available from popping their money in the bank.

The numbers are striking. Between the start of 2003 and its peak on March 9th, Japan's Topix stockmarket index rose by 35%, all because of foreign buying: domestic investors sold all the way up. At its high point in February America's S&P 500 was more than 30% up; NASDAQ, driven by hope and hype, climbed more than 60% by late January before taking a breather. Even European shares went up by 20% or so in a bit more than a year, depending on the measure. Germany's DAX gained more than 40%, despite the economy's flirtation with recession. The emerging-market equities captured in the widely watched MSCI flew up by 50% last year (see chart 1).



Spreads of riskier bonds over riskless government debt collapsed just about everywhere. In Europe an index of liquid eurobonds, compiled by Credit Suisse First Boston, tightened against swaps (the rate at which the best banks lend to one another) by 70 basis points (bps, or hundredths of a percentage point) from their widest point, to 28bps in January. In America, the firm's investment-grade corporate-bond index shrank from 247bps to 84bps over the same period. Junk and emerging-market bonds had their biggest and fastest-ever rally. Not a single issuer in J.P. Morgan's EMBI+ index of emerging-market bonds saw

spreads widen (chart 2).

What began as a legitimate search for higher returns following a collapse in prices in many markets led to valuations that stretched the bounds of credulity and made little or no allowance for error. No matter: even at the start of this year, just about every indicator of risk appetite suggested that investors were, if anything, more gung-ho than ever. Flows into equity mutual funds in America in January reached a size exceeded only in the first two months of 2000. The fund managers surveyed in January by Merrill Lynch were keener than they had ever been on shares, and loathed with equal passion the meagre yields on government bonds. Their appetite for risk has meant a buoyant start to the year for initial public offerings after a fallow 2003 (see article).

There were certainly good reasons for this enthusiasm for equities, beyond low interest rates and heady growth. Profits, especially in America, have been extraordinarily strong. Share prices have also been supported by greater certainty about those profits. A much-followed measure of this, the Chicago Board Options Exchange's VIX index, which measures the volatility of options on the S&P 500, fell by more than half; by the middle of January it was at levels last seen in 1996.

But what if?

It is a good rule of thumb, however, that if things cannot get any better, they can only get worse. So it has turned out. To grim news about lack of job growth in America has been added grimmer news about the terrorist attacks in Spain, and surveys suggesting that consumers in both America and Europe are starting to fret. So are some economists, worried that last year's sharp pick-up in growth in America and elsewhere might not be sustainable. Having started the year in bullish mood, investors have become more skittish too. In Merrill Lynch's latest survey only 48% now expect the global economy to strengthen this year, compared with 74% in January.

And if it does not? Then government bonds are not as expensive as many had thought, and shares and corporate bonds are rather more expensive—and the riskier the asset and the loftier its price, the dearer it will look. Thus the prices of American Treasuries have soared and their yields have dropped. At the start of the year, ten-year Treasuries yielded 4.3%, which most investors thought absurdly low. They must think today's prices even sillier: recently the yield tumbled below 3.7%.

Admittedly, the Treasury market has been given a boost by foreign central banks, not least the Bank of Japan, which have been buying masses of American government debt as a by-product of huge intervention in the currency markets. Yields have also been driven lower by Freddie Mac and Fannie Mae, America's two mortgage giants, which have been forced to buy Treasuries as yields dropped, to replace the mortgages in their portfolios that have disappeared as homeowners have swapped them for cheaper ones. Many fund managers have bought out of simple fear that yields might fall further still. But for all that, the low yields on Treasuries contain an unpleasant message for investors that have been buying without heed to risk or price—that there is much uncertainty about future economic growth.

That message, and its corollary—that risk is ill rewarded—seems to be filtering through at last. From the middle of January, investors started to dump risky, generously valued assets. The pace has picked up in the past couple of weeks. Stockmarkets have been falling: the S&P 500 is now 5% off its mid-January high, and NASDAQ has dropped some 10%. The VIX has climbed sharply, and so have bond spreads—for investment-grade corporates as well as for the most toxic sort.

Stocks and bonds issued by companies most exposed to the business cycle and terrorism, such as airlines, have been hard hit. Investors are plagued by doubts about Detroit's Big Three carmakers. Spreads on their bonds have widened sharply, and those issued by Ford—the world's biggest issuer of corporate debt—have fared very poorly recently. Against stiff competition, the auto sector, down 17% so far this year, has been one of the worst performing in the S&P 500.

A storm in a teacup, or a prelude of worse to come? By historic measures few equity or corporate-bond

markets are cheap; many are very expensive indeed. This makes it all the more possible that a virtuous cycle of rising growth and appetite for risk can turn into a vicious cycle of falling growth and aversion to risk—whatever the Fed does.

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Initial public offerings

Flotation fever

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IPOs are making a comeback

YOU might think that a revival in initial public offerings (IPOs)—sales of shares by companies to the public for the first time—would have to wait until the lessons of 1999 and 2000 had faded far into history. Last year, indeed, only $45 billion was raised in IPOs worldwide, the least in over a decade. How short memories are. A new enthusiasm for new shares is afoot.

In America 29 companies have raised a total of over $6 billion this year, compared with three deals producing less than $300m by the same point in 2003. Japan has already seen 40 new issues in 2004, more than any other rich country, according to Dealogic, a company which tracks such things. In Europe, even a dull old landline-telecoms firm can offer shares, as Belgacom, Belgium's state-owned telephone company, plans later this month.

The boom extends to emerging economies, especially in Asia. In China, which produced only two fewer IPOs than America in 2003, Semiconductor Manufacturing International Corporation came to market this week and raised around $1.8 billion. Investors in China seem remarkably unworried about questions of property rights and whether they will be able to get their money out. India is also getting in on the act: its state-owned Oil and Natural Gas Corporation is selling shares in order to help the government plug the public-sector deficit.

Chalk all this up to rich-country investors' raging thirst for risk. Demand for equities, backed by a surge of new mutual-fund money in America in January alone, has been rising in part because investors can find few other attractive bets. The demand for new shares is easily matched by supply: venture capitalists and private-equity firms are sitting on a hoard of investments made in the previous wave of optimism that they have been waiting for years to unload. Governments are also keen to sell stakes and raise money. At the present pace, perhaps $75 billion-worth of IPOs could be launched this year, the most since 2001 (see chart).

Yet there are worrying signs of a return of risky technology offerings. For example, a nanotechnology company called Polaron, which is slated to list on London's AIM growth-stock market, is expected to have a price-earnings ratio of just under 50. At least it has earnings, something that can be said for only half of the IPOs today in America and Britain.

For investment bankers, at least, a sign that the good times are truly back would be the long-awaited flotation of Google, an enormously popular internet search engine. Once expected in April, this has now been delayed. But another profitable dotcom company, salesforce.com, is likely to float soon.

Will big deals by fairly established firms inspire a string of more questionable new companies to offer shares to the public? Possibly—but in the United States at least, it is harder than in 1999 for a firm to make its stockmarket debut. New auditing requirements inspired by the Sarbanes-Oxley act have doubled the cost of preparing a firm's books for the public, according to one executive. Premiums for directors' and officers' insurance, which companies buy to protect their top staff from shareholder lawsuits, have soared. By one estimate, a new firm in America needs around $100m in sales to make an IPO worthwhile, compared with $50m a few years ago. Until European regulations are also tightened, Europe—alongside emerging markets—may be a more fertile place for speculative offerings.

In the wake of the dotcom bust, you might expect investors to scrutinise IPOs much more closely than before. Yet many recent issues have been handsomely oversubscribed, and the first-day “pops” in share prices, while well short of those in the bubble years, are high. This suggests that even today fund managers are buying on the basis of faith as much as analysis.

As Jay Ritter, a professor at the University of Florida, points out, enthusiasm for IPOs has always been strongly correlated with market peaks, measured by the ratio of capitalisation to the book values of companies and by price-earnings ratios. Moreover, says Mr Ritter, for the past two decades long-term returns from IPOs bought on their first day of trading have been persistently lower than those on other shares. Recently stockmarkets have faded a little from their recent highs. Is the smart money already starting to sell?

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America's mutual-fund scandal

Unsettling

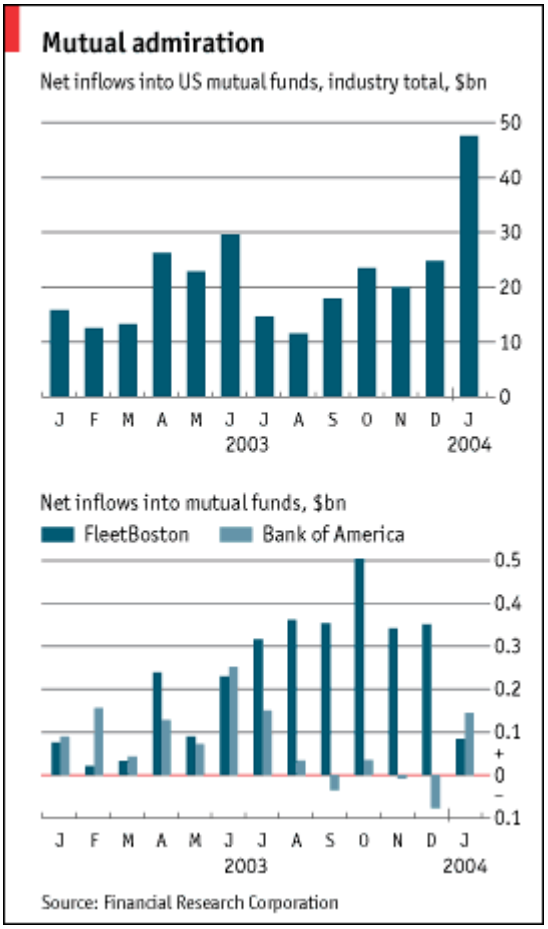
Mar 18th 2004 | NEW YORK
From The Economist print edition

A big legal settlement has more bark than bite

SECURITIES law makes it plain: America's mutual funds are to be managed on behalf of investors—not the people who sell funds or advise fund managers. This put prosecutors on strong ground when evidence emerged last year that many fund companies and their advisers had cooked up side deals that yielded extra fees but diluted investors' returns. On March 15th the Securities and Exchange Commission (SEC) and New York's attorney-general, Eliot Spitzer, announced the largest settlement since the scandal broke: a $675m agreement with Bank of America (BofA) and FleetBoston Financial. BofA's $47 billion takeover of FleetBoston was approved by shareholders two days later.

Both banks' mutual-fund subsidiaries were alleged to have allowed “market timers” to trade in and out of their funds, generating higher costs that ate into long-term investors' returns. The scale of the settlement ought to deter other fund-management companies from shafting their customers, at least for a while. Mr Spitzer noted that mutual-fund companies have been penalised to the tune of $1.65 billion so far, $250m more than investment banks settled for last April over conflicts of interest in equity research.

Like the investment-bank settlement, this week's agreement is less punitive than the seven-figure sum suggests. As with the Wall Street penalties, the mutual-fund fines are easily digestible: they amount to only 2% of the combined banks' forecast earnings this year. As in the investment-bank case, no senior executives of the parent companies have been held liable. Nor will the banks have to divest their mutual-fund operations.



Another similarity is that the formula used to set the mutual-fund penalties, like that in the Wall Street settlement, has no clear economic basis. Thus, one-quarter of the money is not a fine but an estimate of foregone revenue under an agreement to cut fees over the next five years. But, lower fees—depending on how investors and competitors respond—could give BofA an edge in a market where demand shows little sign of abating (see chart). Conceivably, revenues could go up. On the other hand, if investors are turned off BofA by the scandal, it will have fewer assets to manage—and this will reduce the amount of foregone revenue. And, reduced fees will benefit future investors, not those who were hurt by market timing. Wouldn't a plain fine have been simpler, or retrospective reimbursement more fitting?

The settlement also leaves unclear what price managers should pay for their mistakes. It requires eight of BofA's fund directors to leave, but only over the next year. None will be prosecuted, although they are alleged to have been aware of the special trading arrangement. In addition, BofA will be allowed to continue as manager of its own subsidiaries' funds, despite its breach of its obligation to investors. Similarly, the directors of FleetBoston's fund subsidiary, Columbia Advisors, have not asked for the parent bank's resignation as fund manager. Perhaps this was because regulators negotiated not with the funds' directors but with the banks.

This outcome was particularly inappropriate in the case of Columbia, says Roy Weitz, editor of *Fund Alarm*, an online newsletter. One of the funds involved was for young investors. It claimed to have an "educational objective to teach children and teenagers about mutual funds, basic economic principles, and personal finance". According to the SEC complaint, a hedge fund was allowed to make over 200 market-timing trades in the fund during 2000 alone. "This was a serious case and they didn't go after anyone," says Mr Weitz. "If no one got fired here, it is hard to see where they would."

Still, there was a bright spot this week, thanks to MFS Investment Management, America's oldest fund company, which settled its own market-timing case with the SEC in February. On March 17th, its new non-executive chairman, Robert Pozen, announced that MFS would curtail the practice, common in the industry, of recouping certain costs from trading spreads rather than making them explicit.

This so-called soft-dollar business has allowed anything from research to marketing to be financed by investors who had no idea what they were buying. If other companies followed MFS's example, investors would be far better informed about the costs of mutual funds. This would do more than any agreement with regulators to put downward pressure on fees. Mr Spitzer and the SEC have several cases still outstanding. They may want to take note.

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Investment research

The information gap

Mar 18th 2004
From The Economist print edition

More allegations of murkiness at investment banks, and more efforts to clean up

IN THE wake of the scandals on Wall Street, equity analysts were branded the bad boys of investment research. While securities firms were merrily flogging new share issues left, right and centre, some analysts were lauding shares in public and dissing them in private. Since then investment banks have been obliged to reduce such conflicts of interest. The incentive for credit analysts, who look at company debt rather than shares, to exploit similar conflicts was never as great: the fees from underwriting debt issues do not compare with those from share flotations.

Still, it seems that on the debt side temptation was not entirely absent. It was reported this week that according to documents filed in a federal court in New York, in February 2001 analysts at J.P. Morgan, Deutsche Bank and Bank of America downgraded their verdicts on the creditworthiness of WorldCom. A Deutsche analyst even recommended that the bank limit its loan exposure and not lend WorldCom more money. But the banks did not share these worries with their clients. In May, all three helped the company sell $12 billion in debt. It was the third-biggest debt offering ever.

Could this happen today, after all Wall Street's efforts to clean up investment research? In April 2003 investment banks settled charges that they had either touted rotten shares or given company bosses favours in order to gain investment-banking fees. The banks promised to obey the Securities and Exchange Commission's (SEC) new rules of conduct, designed to reduce conflicts of interest for equity analysts. Besides physically separating researchers from investment bankers, they established separate reporting lines, budgets, and legal and compliance teams.

Many big banks now oblige bankers and analysts to be chaperoned by a lawyer whenever they talk to each other. Analysts' security passes do not work on bankers' floors, and vice versa. Computer firewalls block e-mails between the two groups. At Goldman Sachs and a couple of other firms, analysts can now turn to an internal ombudsman if they feel under pressure from investment-banking colleagues or clients to say nice things about the companies they cover.

Investment banks have already taken steps to reorganise debt research too. On March 12th Morgan Stanley became the latest to announce new firewalls at their offices in New York, London and Tokyo that will separate fixed-income research from traders and sales staff. The bank says traders would always be tempted to look at unpublished credit research and analysts to peek at non-public trading positions if they continued to sit together. “Debt analysts, traders and sales staff should still talk, because otherwise analysts would not be relevant,” says Justin Simpson, head of interest-rate strategy at Morgan Stanley. However, they should be constantly reminded not to give out any information they would not also disclose to a good client.

If they are not allowed to share any confidential information, how useful are analysts to investment banks? They generate no income directly, and some of them are still very expensive. Investment banks admit analysts' contribution is tricky to quantify—and have got rid of a fair few in the past couple of years. But fixed-income traders have to rely on analysts' advice to make quick decisions for their clients in a market where dozens of factors, from movements in interest rates to terrorist attacks, can have rapid effects on prices.

Regulators and trade groups are joining the effort to reform research too. In early 2003 the SEC introduced an “analyst certification” for equity and debt research. Debt and equity analysts must affirm routinely that they believe what they write and are not distorting their views to please their paymasters. On March 11th the Association of Investment Management and Research and the National Investor Relations Institute released an ethics code for equity analysts.

If investment bankers are increasingly cut off from the information that analysts glean about companies, is there much point in keeping analysts at all? At least one big institution has been thinking of shutting its credit-research department. According to Harvard University's Samuel Hayes, investment bankers are vendors of information and products based on the freshest intelligence. Walling off research from the rest of the firm is a severe constraint on the investment banker plying his trade, says Mr Hayes. The walls are getting ever higher and thicker.

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Auditing reform

More rules

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From The Economist print edition

This time in Europe

WHEN the accounting scams at Enron and WorldCom came to light three years ago, it was common to hear Europeans tut-tutting about America's need to put its house in order. But scandals at Parmalat, an Italian dairy company, and Ahold, a Dutch food retailer, have shown that Europe too could be tidier. On March 16th, the European Commission proposed new, stricter rules for the auditing of European companies.

The proposals, which must still be approved by European Union ministers and the European Parliament, have long been in the works. “We've been looking at auditing for years,” says Jonathan Todd, a commission spokesman. “The proposal was not a knee-jerk response, like Sarbanes-Oxley was.”

Even so, the passage of America's Sarbanes-Oxley act, which was rushed through Congress in 2002 to fix the corporate-governance and auditing holes exposed by Enron and the rest, seems to have kicked Europe's protracted process into gear. “Parmalat was an extra boost, but the real motor was Sarbanes-Oxley,” says Neil Lerner, head of regulatory issues at KPMG, an auditing firm. “Europe had to stand up and be counted.”

In fact, the commission's proposals bear a lot of similarity to America's new rules. This is probably necessary, given the need to co-ordinate the regulation of multinational companies. The European version calls for an end to auditors' self-regulation, requiring individual countries to set up regulators similar to America's newish Public Company Accounting Oversight Board. The commission also wants to oblige public companies to establish independent committees to hire and fire auditors, as in America. And it would require non-EU auditors to register with local authorities—mirroring a provision in the Sarbanes-Oxley act that provoked rage among European auditors.

The commission also calls for tougher sanctions for wayward accountants and increased co-operation among various EU supervisors. It gives individual countries the option of making compulsory the regular rotation of auditors or the senior partner dealing with an account. The idea is that long relationships can lead to over-cosy ties and lax audits. Auditors think that rotation would worsen audit quality, because accountants would have to learn about their clients afresh every few years.

Yet there are differences between what the United States has and what Europe might get. America's rules are much more prescriptive and numerous. For example, the American ban on accounting firms providing some (but not all) non-audit work to audit clients, the certification of company accounts by company bosses and the requirement that a “financial expert” (painstakingly defined by the SEC) be on each audit committee do not feature in the commission's proposals.

America's more detailed rules may reflect its more litigious society. The question is whether Europe's principles-based approach can endure. As the participation by Italian shareholders in American class-action suits against Parmalat show, litigiousness is not a trait confined to America. And, given that the commission's proposals are still open to change, some auditors are worried that one more big corporate scandal could yet push Europe towards more detailed, far-reaching legislation similar to Sarbanes-Oxley.

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The Australian economy

A wonder down under

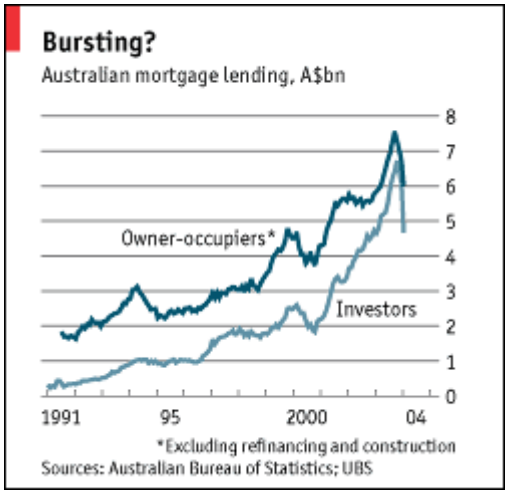
Mar 18th 2004 | SYDNEY
From The Economist print edition

Are Australia's economic batteries running low?

Get article background

FOR a dozen years Australia's economy has kept going like the Energizer bunny. It is now in its 13th year of expansion: in the past 12, GDP growth has averaged almost 4% a year. But could 13 prove to be an unlucky number?

Australia is basking in some of its best economic numbers for decades. The unemployment rate has fallen from almost 11% in 1992 to below 6% now. Inflation remains well behaved at 2.4%. The country's stunning performance has been due largely to prudent monetary and fiscal policies and to structural reforms. Lower trade barriers, more flexible labour practices and deregulated product markets have boosted productivity and made the economy better able to adjust to shocks. The rate of labour-productivity growth has risen from an annual average of 1.6% in the 1980s to 2.7% over the past ten years—even faster than in America.



Can the party last? There are two main threats to Australia's boom: its stronger currency and its overheated housing market. Over the past two years, the Aussie dollar has risen by 50% against its American counterpart, and by 30% on a broad, trade-weighted basis. Short-term interest rates of 5.25%, well above America's 1%, have attracted short-term capital from abroad, pushing up the currency.

Almost 60% of Australia's exports go to Asia, and their competitiveness there has been severely squeezed as the region's governments have intervened to hold down their currencies. However, the adverse impact of a stronger dollar on exports has been partly offset by stronger global demand for commodities, especially from China.

Australia had a current-account deficit of 6% of GDP last year, the biggest of any rich economy. The country has run a deficit continuously for 30 years, but last year's was its biggest yet, driven not only by weak exports but also by rapid growth in consumer spending.

In recent years large increases in house prices and household borrowing have given a strong boost to consumer spending. That is why the biggest risk to Australia's economy lies in its housing market. Average home prices rose by 19% last year, pushing prices to record levels in relation to both average incomes and rents.

But what makes Australia's house-price boom look even more fragile than those in Britain or America is the extraordinary importance of the buy-to-let market, which accounted for 45% of all new mortgage borrowing last year. One Australian household in six owns an investment property. New construction has produced a glut of homes, and net rental yields (after maintenance and letting costs) have been driven down to 2%, far below the 7% mortgage rate. People have been buying purely in the expectation of capital gain, regardless of the underlying income stream. This is the very definition of a bubble.

The increase in household debt (mostly mortgage finance) from 85% of disposable income in 1996 to an estimated 140% at the end of last year, has also been more dramatic than in America or Britain.

Consumers have borrowed more money against the rising value of their homes, allowing them to extract some of their capital gains and so spend more than their income: the saving rate has fallen from 9% in 1990 to minus 2% last year. A new study by Goldman Sachs has assessed the vulnerability of consumers in 19 countries, based on trends in debt, saving rates and house-price gains. The bank finds that Australia's consumers (jointly with Spain's) are the world's most exposed to higher interest rates or recession.

The Reserve Bank of Australia raised interest rates twice in the last quarter of 2003, partly because of concerns about debt and house prices. In the same quarter the index of house prices calculated by the Australian Bureau of Statistics accelerated. But data published in the past week suggest that the market is cooling rapidly.

New mortgage lending to investors fell 16% in January, the third monthly fall running; late last year it was rising at an annual pace of 30%. Lending to owner-occupiers has also decreased sharply. The prices of inner-city apartments in Sydney and Melbourne are in retreat.

If average house prices decline nationally, consumer spending would slow sharply. Indeed, housing is such an important part of Australian wealth that a big fall in prices could even tip the economy into recession. And then the “lucky country” would run out of luck.

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Economics focus

A smoother ride

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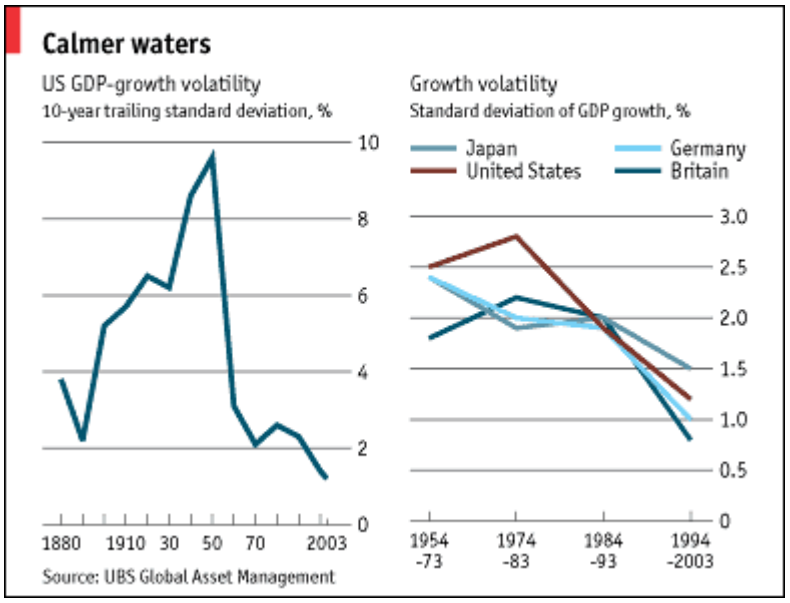
The world economy has enjoyed its most stable decade in history. Can this stability last?

IT IS often claimed that the world has become a more uncertain and riskier place in which to do business, as a result of terrorism, turbulent financial markets and corporate corruption. Yet in many ways economies have become much less risky. A new study* shows that most countries' growth has been less volatile during the past decade than at any time in recorded history.

The study's authors, Bill Martin of UBS Global Asset Management and Robert Rowthorn of the University of Cambridge, calculate that the volatility of American output (measured by the standard deviation of annual changes in GDP) in the ten years to 2003 was less than half that during the decade to 1983, a period which included two oil shocks. Despite the collapse in share prices, America's recession in 2001 was its mildest in history. Look back further and the relative steadiness of the past ten years is even more striking (see left-hand chart). America's growth was six times more volatile on average during the 40 years to 1950 than during the past decade.



Output growth in other big rich economies has also bounced around much less during the past ten years than during previous decades (see right-hand chart). Among the largest economies, Britain's has been the most stable recently. But Germany and Japan have also seen much smaller year-to-year swings in growth. The snag is that in these countries output growth has settled around a much lower average rate.

It is fairly easy to explain why economic cycles have been flatter since the second world war than before it. In the late 19th and early 20th centuries, currencies' values were fixed in terms of gold, which meant that monetary policy could not be used to smooth out swings in demand. And since the second world war, the increase in the level of government spending has created automatic stabilisers: unemployment benefits rise as economies go into recession, helping to support demand.

But what explains the increase in economic stability during the past 20 years? There are three popular candidates: structural changes, such as better inventory control by firms or the shift from manufacturing to services; better policy; or good luck, in the shape of fewer economic shocks. After closer scrutiny,

many economists have ruled out structural change. Governments and central bankers like to take the credit for better policies—notably the defeat of inflation, which used to exacerbate booms and busts. But at last year's annual meeting of central bankers in Jackson Hole, Wyoming, James Stock and Mark Watson, two American economists, presented a paper which concluded that the greater stability of America's economic activity had little to do with monetary policy and a lot to do with luck.

The central bankers were not amused. They will be much happier to hear that Messrs Martin and Rowthorn reckon that changes in monetary policy should take most of the credit for the reduction in macroeconomic volatility. Policymakers now have a better understanding of the inflationary process, and the creation of independent central banks has shielded them from political pressure. To compare the importance of monetary policy in reducing growth volatility with that of changes in the size of shocks, the authors use an economic model to test how today's economies would have coped with such buffetings as the 1970s oil-price hikes and, conversely, how yesterday's economies would have performed given today's smaller upsets.

Their initial finding is that fewer shocks can explain most of the decline in output volatility in America and Britain. But central bankers may themselves have done a lot to make output shocks smaller by getting inflation under control and thus by anchoring inflationary expectations at a low level. In the 1970s, both inflation and expectations were highly volatile. When inflation jumped, workers quickly demanded bigger pay rises and so the loss of output was all the greater. Messrs Martin and Rowthorn also suggest that the oil-price shocks were partly caused by overly lax monetary policies, which encouraged OPEC to adopt a more aggressive stance. Since then, declines in both inflation and its variability have helped to reduce such effects. The success of central banks in keeping inflation low has won them credibility and so lowered inflationary expectations. Once they take account of this indirect effect, the authors conclude that in America, Britain and the euro area better monetary policy accounts for virtually all of the fall in output volatility.

Creating more waves

The implication is that so long as policymakers continue to target low inflation, there is little risk of a return to 1970s-style recessions. That does not mean that the unusual stability of the past decade is sure to be repeated. The authors try to predict future levels of output volatility over the next decade by subjecting their economic model to different hypothetical shocks to output, inflation, interest rates and budget deficits, based on the experience of the past two decades. On the basis of these experiments, they suggest that America's volatility over the next ten years could rise by as much as 50%, roughly back to the same level as in the ten years to 1993, but still low by historical standards.

This is a cheery message for investors: a more stable economy justifies a lower risk premium and hence higher share prices. But the biggest risk to these conclusions is complacency. Once businesses, households and investors think that the economic cycle has been tamed, they may be encouraged to take bigger risks and to act in ways that ensure a deeper future downturn. Such signs are apparent in several economies where household borrowing is surging and housing markets look suspiciously bubbly. Higher levels of debt will make households and hence consumer spending more vulnerable in the next recession. The business cycle has been subdued: it will never be eliminated.

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About sponsorship

The Marjorie Deane internship

Mar 18th 2004
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Applications are invited for the 2004 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a would-be or junior journalist under 28, who will spend three months of the summer at *The Economist*, writing about finance. Applicants should send a letter introducing themselves, with an original article of about 1,000 words intended for the finance and economics section. Applications must reach us by April 5th, and should be posted to: The Business Affairs Editor (Deane internship), *The Economist*, 25 St James's Street, London SW1A 1HG

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Nanotechnology

Much ado about almost nothing

Mar 18th 2004 | BOSTON
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Reuters

The public outcry over genetically modified foods offers several lessons for those working and investing in nanotechnology

Get article background

"THE time for discussion of the rights and wrongs of GM crops has passed. Intense and consistent economic sabotage and intimidation are what will make the commercialisation of GM crops an unattractive option." Words like these, from an article in the current edition of *Earth First!*, a radical environmental journal, send shivers down the spines of those involved in commercialising biotechnology. The strength of public disapproval of genetically modified organisms (GMOs) was a shock and a surprise to most of those involved. Now, some people are wondering whether nanotechnology—a term that covers the manipulation of matter at scales of a millionth of a millimetre—could be in for similar treatment and, if so, whether there are lessons that its protagonists can learn from the public backlash against biotechnology.

Profit of doom

In a neglected corner, amid thousands of participants at Nanotech 2004, a conference held in Boston last week, Jeffrey Matsuura, a law professor at the University of Dayton, in Ohio, stood next to his unprepossessing poster of his work. His warning, however, was pertinent to everyone there—especially the investors who were scouring the conference for opportunities. And this is that several of the factors that created a public backlash against biotechnology are already at work within nanotechnology. Furthermore, he warns that this might ultimately shape the development of the legal, regulatory and public-policy environment.

Dr Matsuura says that biotechnologists assumed that the public would quickly recognise and appreciate biotech's potential for improving the quality of life. Instead, the risks captured the attention of the media and much of the general public. Well-fed European consumers met the suggestion of cheaper food, in particular, with scepticism. Many felt that the gains would accrue to the companies which had developed GMOs, while the risks of growing and consuming the crops would be taken on by the public.

Dr Matsuura believes that public perception of nanotechnology is developing along a similar track. Like those of biotechnology, the first applications of nanotechnology will bring little obvious benefit to consumers. Better, cheaper materials, and hidden manufacturing efficiencies that benefit producers first, are redolent of the “advantages” of biotech—namely reduced applications of agricultural chemicals, which help to keep the cost down while raising yields. Obvious consumer benefits, such as improvements in medicine, are further away.

This should not matter—consumers do benefit eventually, even from cost savings. And yet, in alliance with a feeling that there are hazards involved, an absence of immediate benefits could turn public opinion against nanotech quite rapidly. And potential hazards there are. Concerns over out-of-control, self-replicating “nanobots” that would eventually consume and transform the entire planet into a “grey goo” are absurd. And yet, it is true that novel “nanoparticles” might have real toxicological risks.

Nanoparticles are so small that, if inhaled, they could become lodged in the lungs. In theory, they are small enough to enter living cells and accumulate there. And in January Ken Donaldson, a professor of respiratory toxicology at the University of Edinburgh, told a Royal Institution seminar in London that, once inhaled, ultrafine carbon particles can move to the brain and blood.

There are already several products that use nanoparticles already on the market, such as sunscreen and car parts. Though all this may sound alarming, people are already exposed to nanoparticles of many different kinds, and have been throughout history. Soot, for example, is composed of carbon nanoparticles. Nevertheless, nanoparticles from sources such as diesel soot, welding fumes and photocopier toner are already associated with ill-health. The prospect of more such particles is likely to worry many. No wonder that several people at the conference in Boston mentioned the need to address public fears over nanotechnology “aggressively”.

One of these was Clayton Teague, the director of America's National Nanotechnology Co-ordination Office. He says the American government is as sensitive to any indication of true health risk as any member of the public. Several large and well-funded studies on the environmental and health risks of nanotechnology are now under way.

Dr Teague adds that any decisions about nanotechnology will be made carefully and based on solid scientific data. But even if science gives the go-ahead, another one of Dr Matsuura's lessons is that this might not necessarily win the day, and that fear over potential abuses and accidents may dominate the debate.

One piece of advice Dr Matsuura gives is that everyone involved should have a consistent message. If investors are told a technology will change the world, someone who is concerned about the risks cannot then be told that the same technology is no big deal. It strikes a false note to say that something can be both revolutionary and nothing to worry about, he says. Such inconsistencies will breed public mistrust and fear.

On top of this, some people will worry about which companies control a revolutionary technology, and who has access to it. Concerns over patents on genes have a direct analogy in nanotechnology. In the latter case, people are expressing alarm over claims about basic nanoparticles such as “buckyballs” and carbon nanotubes. Groups such as Greenpeace and the more radical ETC (also known as the Action Group on Erosion, Technology and Concentration) are already warning about a gap developing in the future between nanotechnology “haves” and “have nots”.

Product placement

Donald Reed is a senior consultant with Ecos, a business-advisory firm based in Sydney, Australia, that acts as an intermediary between corporations and activists. He is already working with DuPont, a large chemical firm that has interests in both agricultural biotechnology and nanotechnology. DuPont has hired Ecos to help it tackle emerging nano concerns.

Mr Reed goes as far as to recommend that companies think about the early products they choose to pursue—in particular, whether they can demonstrate the “societal value” of these products. For example, it might be worth emphasising that one of the early products of nanotechnology could be cheap and efficient photovoltaic materials, which are used to generate electricity from sunlight.

Mr Reed says that although only a few groups have expressed concerns about nanotechnology so far, this

was also the case in the early days of biotech. If a bandwagon of fear and mistrust starts rolling, many people may jump on.

Sensitive to this possibility, the British government has commissioned a study into the issues raised by nanotechnology. Scientists and engineers involved have already pointed out that public perceptions are a potential barrier to progress.

In Europe and America, there is the growing sense that one of the most important lessons of the fierce opposition with which biotechnology has met is that, if science is seen to be progressing too fast, and too far beyond current knowledge, there will be pressure for legislation.

If public concern seems trivial at the moment, it is worth remembering the power of the media to inspire alarm. “Jurassic Park”, a movie based on a book by Michael Crichton, did a great deal to generate interest and concern over biotechnology. Ironically, the author's latest tome is about nanotech. There is no release date, yet, but the film is in pre-production.

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Alzheimer's disease

Barking up the wrong tree?

Mar 18th 2004
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Recent research suggests Alzheimer's disease may be triggered by infection

AP

Making years golden

ALZHEIMER'S disease is a problem of old age. In America, there is about a 50% chance that an individual will have developed it by the age of 85. As people live longer, its prevalence rises, and so does the incentive to find out how it works and treat it. But although the changes in the brain that accompany Alzheimer's memory loss are being disentangled, the underlying cause remains mysterious.

Most research has proceeded on the assumption that this cause is internal—either genetic, or a side effect of the general wear and tear that accompanies ageing. But a few years ago, Brian Balin of the Philadelphia College of Osteopathic Medicine looked at the brains of 19 people who had died of Alzheimer's and compared them with 19 people of the same age who had died of other causes. All but two of the Alzheimer's brains had something in common: they harboured a bacterium known as *Chlamydia pneumoniae*. Only one of the non-Alzheimer's brains had this bug in it. That observation raised the possibility that sometimes, at least, Alzheimer's is caused by an infection. This is a controversial idea. But research that is about to be published in the journal *Neurobiology of Aging*, by Dr Balin and his colleagues, suggests it might be right.

The problem with the original observation was that *Chlamydia* is maddeningly common. Typically, the bug causes mild pneumonia, a persistent cough and a low-grade fever. Half of all people in their 20s have been exposed to it, and almost everyone has crossed the bacterium's path by the time they reach old age. Finding evidence of *Chlamydia* in brain tissue from an autopsy therefore means little. Nor does the apparent correlation with Alzheimer's prove anything. It might simply be that brains which are riddled with the “amyloid” protein plaques which characterise the disease are also more susceptible to infection.

However, the idea that common pathogens are the culprits behind several diseases that have not previously been thought of as infections is gaining ground. A bacterium called *Helicobacter pylori*, for example, is now believed to be the main cause of stomach ulcers. And *Chlamydia* itself has possible (though disputed) links with heart disease.

To gather evidence that *Chlamydia* might be causing Alzheimer's disease, rather than merely profiting from it, Dr Balin decided to see if the bug could induce Alzheimer's-like symptoms in mice. He and his colleagues chose a kind of mouse that does not naturally develop amyloid brain-plaques. They then sprayed a strain of the bacterium that had been harvested from human Alzheimer's patients, up the

mice's noses.

One to three months after doing so, Dr Balin killed his mice and examined their brains. All the animals had developed plaques. Moreover, the longer an animal lived after the initial infection, the more plaques it had, and the larger they were.

Dr Balin and his team therefore think that *Chlamydia* may indeed be a trigger for Alzheimer's. Their working hypothesis is that the low-grade infection causes inflammation, which in turn causes the amyloid to start gumming up. (It is well known that people who have taken a lot of anti-inflammatory drugs during their lifetimes are less likely to suffer from Alzheimer's than others.)

That hypothesis is taken further in another paper about to be published—this time in the *Proceedings of the National Academy of Sciences*, by Jeffery Kelly of the Scripps Research Institute in San Diego and his colleagues. One consequence of inflammation is the production of ozone, a highly reactive form of oxygen. This, in turn, reacts with normal body chemicals such as cholesterol, to produce poisons. Among these poisons are a group of chemicals called atheronals. Dr Kelly has now shown that atheronals can, at least in a test tube, trigger the sort of misfolding in amyloid proteins which is believed to lead to the formation of plaques. He has also found atheronals in the brains of Alzheimer's patients, although they exist in people of similar age who have not had Alzheimer's, as well, which weakens the theory somewhat.

Nevertheless, the pieces are coming together. Dr Balin is not claiming that *Chlamydia* is the only thing that can trigger the inflammation that leads to Alzheimer's. But his work suggests that it might be a common trigger. If he is right, the implications could be huge. The surgical removal of stomach ulcers was once a major industry. Now, sufferers are given a course of antibiotics. If a similar treatment could deal with Alzheimer's, a healthier old age might be bought in the same way.

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The solar system

Ten planets, or eight?

Mar 18th 2004
From The Economist print edition

Yet another distant object orbiting the Sun has been discovered

CLYDE TOMBAUGH might have been amused to see how times have changed. After poring over around 40,000 pairs of images to spot a moving dot of light, Tombaugh, a precocious 24 years old at the time, discovered Pluto in 1930. For many years, his discovery remained unique. That led astronomers to dub Pluto the ninth planet, despite the fact that successive attempts to measure its diameter revealed that, at least in terms of size, it resembled the asteroids that live in the inner parts of the solar system more than the other planets.

In 1992, however, Pluto acquired neighbours. The first of the so-called “Kuiper belt objects” was discovered by David Jewitt, of the University of Hawaii. Since then, about 800 such objects have been discovered orbiting at about the same distance as Pluto. Most of them are much smaller than Pluto. But Mike Brown and Chad Trujillo, of the California Institute of Technology, and David Rabinowitz of Yale University, seem intent on giving Tombaugh a run for his money. In June 2002, they discovered Quaoar—at the time the largest Kuiper belt object known, at half the size of Pluto. And on March 15th, they announced the discovery of an object tentatively known as Sedna, after an Inuit goddess of the seas. Sedna is, by a substantial margin, the most distant object yet seen in the solar system. And it is estimated to be three-quarters of the size of Pluto. Those who regard Pluto as a proper planet are going to be hard put to deny that status to Sedna. On the other hand, those who wish to downgrade Pluto to the status of a large asteroid, and reduce the number of “proper” planets to eight, now have further ammunition.

At the moment, Sedna is three times as far away from the Sun as Pluto. But this is almost the closest point of its 10,500-year orbit—an orbit that will eventually carry it a further ten times as far away as Pluto. This, says Dr Brown, means Sedna is probably a member of the Oort cloud, a collection of bodies thought to lie beyond even the remote Kuiper belt. The Oort cloud's existence, like that of the Kuiper belt, was hypothesised in the 1950s. However, until Sedna's discovery, the cloud was thought to lie much further away. According to Dr Brown, the existence of Sedna means it is likely that the Sun formed in a cluster of stars, from which it has since been ejected. Only the gravitational influence of such stars, he reckons, could have stopped an object in Sedna's orbit escaping the solar system.

It is not only Sedna's orbit that appears strange. The object itself is curious. It is the second-reddest body yet seen in the solar system after Mars. It may also have a peculiarly reflective surface. And its slow rotational period (once every 40 days) suggests that, like Pluto, it has a moon—a suggestion Dr Brown hopes to confirm using the *Hubble* space telescope.

Dr Brown discovered Sedna using the Samuel Oschin telescope on Mount Palomar, in California. This telescope has a mirror 120cm (48 inches) across—not particularly large by modern standards. What is large, however, is the camera attached to the telescope. It is a digital camera, with a 170 megapixel light detector, and can thus record very faint objects. (By contrast, the best professional digital cameras on the market have around 10 megapixels.) Recording an object, though, is not enough. You have to recognise its significance. For that, Dr Brown uses a computer program which searches for movement by comparing shots taken at different times. It sounds snazzy, but it is basically the same technique that Tombaugh used in the 1930s. Unfortunately for him, he had to compare his photographs by eye.

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Wacky races

None shall have prizes

Mar 18th 2004 | LAS VEGAS
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DARPA's Grand Challenge turned into a damp squib

Better luck next time, chaps

AFICIONADOS of Professor Pat Pending's protean cartoon racing car would have had a ball. In the end, 13 vehicles made it to the starting line of the Grand Challenge race run on March 13th by the Defence Advanced Research Projects Agency (DARPA), America's main military research body. It was supposed to be 15, but two withdrew. For the superstitious, the number of starters was a portent of things to come.

The Grand Challenge was a race with a difference: the entrants were all robots. The course was 227km (142 miles) of the Mojave desert in California and Nevada. And the vehicles had to work out the navigation—and how to avoid any obstacles—by themselves, rather than having it programmed into them.

In the event, the best any could manage was 12km. That was achieved by *Sandstorm*, a machine entered by a team from Carnegie Mellon University in Pittsburgh. It gave up the ghost when its tyres caught fire. So no one won the $1m on offer to the team whose machine was first to cross the finishing line.

In truth, nobody really expected any of the entrants to make it to the end this time. Robots are not yet that advanced or robust. But the exercise was not a complete waste of time, since learning from mistakes is the primary way that technology advances. Indeed DARPA, whose motive is to encourage as many engineers as possible to think about the problem of robotics, with a view to “demanning” a large part of America's army over the next decade or two, plans to run the competition again in 2006. Time to start designing your entry.

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Anti-western fanatics

On their feet

Mar 18th 2004
From The Economist print edition

Reuters

Why is the West so hated? A new book sheds light on an ancient animosity

MORE than two years on, the September 11th assault on America still defies comprehension—as do the Madrid bombings last week. To al-Qaeda's sympathisers the 2001 attacks seemed an heroic puncturing of American hubris. To many others they remained shocking but somehow random acts of barbarous lunacy. Other people needed to fit the atrocity into some broader pattern. To Tony Blair, speaking on March 5th, less than a week before the Madrid attacks, September 11th amounted to a "declaration of war by religious fanatics who were prepared to wage that war without limit". But this is little help in understanding their motivation.

Occidentalism: The West in the Eyes of its Enemies
By Ian Buruma and Avishai Margalit

The Penguin Press; 160 pages; $21.95

Buy it at
Amazon.com
Amazon.co.uk

"Occidentalism" is a succinct, elegant and challenging attempt both to credit the attackers with a coherent ideology, and to put it into an historical context. The authors bring to the effort a formidable combined record as analysts of a wide range of societies and cultures, and of issues of collective memory, guilt and retribution.

Their thesis refers to "Orientalism", a book published in 1978 by Edward Said, a Palestinian writer who died last year. Said's argument was that western scholarship disdains and distorts the Islamic world in subtle ways that provided an intellectual backdrop to colonialism and post-colonial domination. In the authors' summary: "Some Orientalist prejudices made non-western people seem less than fully adult human beings; they had the minds of children, and could thus be treated as lesser breeds."

Occidentalism is the mirror image of this: the dehumanising view of the West held by many of its enemies. It reduces the West, and especially America, to a symbol of evil, "a mass of soulless, decadent, money-grubbing, rootless, faithless, unfeeling parasites". For Occidentalist fanatics such as Osama bin Laden, this legitimises mass murder.

The authors' innovation is to see present-day Islamic extremism as just one manifestation of a rejection of western values that can be traced back to the birth of those values in the Enlightenment—and indeed, far beyond to ancient biblical myths about the destruction of the sinful city. The parallels they draw are

diverse: the Assassins, a rebellious sectarian Muslim cult of the 11th and 12th centuries; Japanese *kamikaze* pilots of the second world war; Chinese Maoists and their Khmer Rouge heirs in Cambodia; 19th-century Russian slavophiles; Stalin; the Nazis.

So you do not have to be an oriental to be an Occidentalist, or vice versa. Whole countries, such as Japan, can move from one camp to the other in a single generation. Indeed, the book contends that most forms of Occidentalism, even outside the West, borrow heavily from western ideas. A partial exception is extremist Islam: “Its depiction of western civilisation as a form of idolatrous barbarism is an original contribution to the rich history of Occidentalism.” This gives Islamist terrorism its apocalyptic colour—good taking on evil.

But the authors do not interpret the world's present predicament as a clash between the West and Islam. They see instead a lengthy battle of ideas in defence of the open, the tolerant and the free against totalitarian ideologies both religious and secular. They warn against the utter refusal to try to understand fanaticism and the cringe of colonial guilt that appears to justify it. However much damage the West did and does to the East, that does not excuse barbarism. To argue that it does is Orientalist condescension.

The same accusation, of course, could be made against their claim that “not even the most fervent holy warrior can ever be entirely free of the Occident”. But they are surely right to see their story as one of “cross-contamination, the spread of bad ideas”, and to conclude that the West's biggest mistake would be merely to try and protect itself instead of thinking deeply how to promote a better understanding between the two sides.

The book, we are told, stems from a conversation the two authors had in north London, in front of Karl Marx's tomb. It sometimes seems to promise more than it can hope to deliver. Its insights and the links it makes are illuminating, and help show that the divide between the West and its enemies is an old one. But that makes it seem no less unbridgeable. “The philosophers have only interpreted the world in various ways,” reads the unfair stricture from Marx on his tomb. “The point, however, is to change it.”

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By Ian Buruma and Avishai Margalit.
The Penguin Press; 160 pages; $21.95

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About sponsorship

The Iraq war

A soldier's lot

Mar 18th 2004
From The Economist print edition

WAR creates opportunities for brutishness and baseness, but also for great human accomplishment. It is this dichotomy that attracts Rick Atkinson, a former staff writer at the *Washington Post* and author of several respected books on conflict.

The son of a career army officer, Mr Atkinson has a deep-rooted admiration for soldiers and their craft. He makes no secret of his respect for the common soldier and his disdain for the many politicians whom he feels often put them in harm's way. And yet he also shows his American fighting man without any veneer: at times selfless, resourceful and kind, at others thoughtless, crude and devoid of tact or empathy towards the local population.

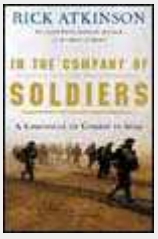
“In the Company of Soldiers”, a war diary of the 101st Airborne Division's experiences during the Iraq war, brings to life the lot of the common soldier. Two things distinguish this from other, similar accounts: Mr Atkinson's unfettered access to the 101st's divisional commander, Major General David Petraeus, and his reputation as the author of “An Army at Dawn”. His chronicle of the Anglo-American campaign in North Africa, which lasted for just seven months of 1942—from the first inauspicious landings in French Morocco to the Axis defeat in Tunisia—married together official accounts, private diaries, letters and statistics with narrative flair, humour and a deep sense of the epic. Few were surprised when it won a Pulitzer prize.

Many of the experiences Mr Atkinson recounts are perennial: soldiers longing for home and its comforts, the incomprehensible grief at friendly-fire casualties, the rivalries between supposed brothers-in-arms, the inhuman exhaustion, and above all the pervasive, surreal madness of the battlefield. General Petraeus is sanguine about firing into civilian areas to protect his own troops, and yet ruminates optimistically: “Wouldn't it be wonderful if this place turns out to be something?”

Written before the smoke had cleared from the field of battle, Mr Atkinson's latest account sits somewhat uncomfortably between narrative and history in contrast to his masterpiece on the campaign in North Africa. “In the Company of Soldiers” lacks a substantive overview, but it is still a fascinating first-hand account. And anyone reading Mr Atkinson's thoughtful books will come to the realisation that soldiers are fated, like Sisyphus, to relive the same events again and again.

In the Company of Soldiers: A Chronicle of Combat.
By Rick Atkinson.
Henry Holt; 336 pages; $25. Little, Brown; £9.99

In the Company of Soldiers: A Chronicle of Combat
By Rick Atkinson



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The environment

Green reflections

Mar 18th 2004
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"WE LIVE in a global consumer society, a material world, with seemingly endless consumer demands. Why should it be so?" Those words, drawn from "Red Sky at Morning", seem to be the sort of lament often heard in simple-minded books about the environment. The planet is in imminent danger, goes the argument, the air and water are getting filthier, and it is all due to the evils of capitalism and the gluttony of mankind.

At first blush, James Gustave Speth seems perfect for the part of bleating environmentalist. After all, his green credentials are impeccable. He founded not one but two high churches of the American environmental movement: the Natural Resources Defence Council, a litigious non-governmental group, and the World Resources Institute, a think-tank. He also served as head of the United Nations Development Programme, which often complains about resource degradation, and is now dean of Yale University's environment school. This book adds up to his reflections on a lifetime of fighting for the environment.

Red Sky at Morning: America and the Crisis of the Global Environment—A Citizen's Agenda for Action
By James Gustave Speth

Yale University Press; 299 pages; $24 and £16.95

Buy it at
Amazon.com
Amazon.co.uk

Yet, consider Mr Speth's delightfully contrarian answer to that question about excessive consumerism: "Consumption brings us pleasure and helps us to avoid pain and, worst of all, boredom and monotony. Consumption is stimulating, diverting, absorbing, defining, empowering, relaxing, fulfilling, educational, rewarding. If pressed, I would have to confess that I truly enjoy most of the things on which I spend money."

Clearly, this man is not your run-of-the-mill environmental Cassandra. On the contrary, Mr Speth is a thoughtful and well-informed observer of the environmental scene, and his book is a balanced and pragmatic look at the topic. His broad thesis is that the world faces some difficult environmental challenges in the years ahead—chief among them climate change—and that it is ill-equipped to tackle those challenges. He contrasts such difficulties with local environmental problems, which the rich world has successfully tackled, and explains the reasons why global problems are likely to prove thornier. Unlike smog or filthy water, which ordinary people can see and smell, climate change or the depletion of the ozone layer are harder problems to comprehend and, therefore, to deal with.

AP

From a generation of talkers

He is scathing in his denunciation of the current approach to dealing with international environmental problems, which basically amounts to endless conferences ("my generation is a generation, I fear, of great talkers," he observes wryly) and the crafting of treaties that are often ignored. He notes that there are some 250 such treaties, but little co-ordination or hope of implementation.

He offers up a number of suggestions for improving "global environmental governance" arising from his decades of experience. His proposals are mostly sensible ones. Importantly, they are informed by the notion that mankind must balance the needs of the world's poorest with concerns about nature. He even makes a semi-plausible case for a new World Environment Organisation to counter-balance the World Trade Organisation without invoking the usual empty-headed arguments against globalisation.

That points to this book's greatest strength. In making his case, Mr Speth is careful to avoid the usual pitfalls of green books. He readily recognises that the air and water in rich countries have been cleaned up over the past few decades—a fact that most green groups are not keen to trumpet. He honestly accepts that he and others making predictions back in the 1970s got some gloomy forecasts wrong: he notes the world's population did not explode, for example, nor did prices for food and minerals. Influenced by his time running UNDP, he is careful not to put green goals on an altar while neglecting global poverty. Indeed, he makes the sharp observation that poverty in itself forces the indigent to despoil their natural environment—and economic growth, the *bête noire* of many greens, is necessary to lift those unfortunates out of subsistence.

What is more, unlike many greens, he is no Luddite. Mr Speth clearly understands the power of human ingenuity and calls for measures to encourage the development and use of clean new technologies. How? In part by unleashing market forces, he says. Mr Speth makes a compelling case for stripping away perverse subsidies and introducing market-based regulatory approaches like emissions trading.

Occasionally, the author strikes a sour note, which is unwelcome. He sometimes slips into the tone of lecturing grandfather or hectoring green, which can be annoying. And he cites one too many arcane or ancient reports at length, which can be tedious as well as annoying. Even so, these are minor flaws in an otherwise thought-provoking book by one of the grand old men of greenery.

Red Sky at Morning: America and the Crisis of the Global Environment—A Citizen's Agenda for Action. By James Gustave Speth.
Yale University Press; 299 pages; $24 and £16.95

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Christianity

Onward and upward

Mar 18th 2004
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IF SHE could have lived her life backwards, perhaps Karen Armstrong would have enjoyed it more. She now lives a solitary existence focused on trying to understand God and explain him.

That was pretty much what she was aiming for 40 years ago, when she became a nun in a teaching order. But in those days, Roman Catholic religious life was cold, arid and perversely strict. From the viewpoint of modern Christianity, it seems almost incomprehensible that a religion founded on love, truth and justice could be expressed in the vigorous repression of emotions, intellect and conscience. So Ms Armstrong was miserable as a nun, as she has already described in the first volume of her autobiography, “Through the Narrow Gate” (1981).

Her new book explains how she bumped her way back to a happy if solitary existence in the outside world, via Oxford University, school-teaching and journalism. Unusually in the autobiographical genre, it is a second attempt. Her first account of this chapter of her life outside is long out of print; she describes its jolly tones as the “worst book I have written”.

The Spiral Staircase: My Climb out of Darkness
By Karen Armstrong

Knopf; 306 pages; $24.
HarperCollins; £20

Buy it at
Amazon.com
Amazon.co.uk

Her new book is neither bad nor jolly, but it is baffling. So many horrid but avoidable things happen that one wonders if the author harbours a secret masochism. Her undiagnosed epilepsy, for example, crippled her for years. It was eventually recognised and treated. Yet it seems odd that neither she, nor her friends and colleagues, let alone the many doctors and psychiatrists who dealt with her, ever thought there might be a simple physiological explanation for her funny turns.

She almost starved herself as a post-graduate student at Oxford, yet had by today's standards a generous grant. Despite getting a congratulatory first in her undergraduate degree, her doctoral thesis was failed on a whim, thus ending any chances of an academic career there. Oxford acknowledged that an injustice had been done but decided that re-examining it would set a dangerous precedent. This too seems very odd; with a word in the right ear, academic bureaucrats can usually find ways round these things.

Later, when teaching in south London, she decided to live far away in north London, in order, she says, as if this were an obvious reason, not to be too near the school. Not only that, she insisted on making an exhausting hour-long bus journey there and back each day, rather than pay slightly more and go by train.

But the biggest puzzle is Ms Armstrong's tortured spiritual and intellectual odyssey. Her early religious belief seems to have been driven by a combination of puzzlement and willpower, rather than any feeling of transcendence. It seems odd that someone so clever, who had spent so much of her life dealing with Christianity, should find out some fairly commonplace things about her former religion only through making a television programme. She seems genuinely shocked to have learnt that it was largely St Paul who created a church and a religion out of Christ's teaching, and that Jewish prayers and theology, then and now, are rich and attractive.

The characterisations of scenes and people are excellent. But it is mystifying stuff. Ms Armstrong inflicts worry and suffering on her friends and family, while inspiring love and loyalty. Yet she seems numb to both her own feelings and theirs.

Her own beliefs, drawing on many faiths, have become an appealing if slightly woolly blend of sensibility

to poetry (T.S. Eliot in particular), ethics and deism. Her life now, as what could be termed a lay nun, uses writing and broadcasting to make religion more comprehensible to a public that would find the devotional route offputting.

The Spiral Staircase: My Climb out of Darkness.
By Karen Armstrong.
Knopf; 306 pages; $24.
HarperCollins; £20

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New thrillers

Lush living

Mar 18th 2004
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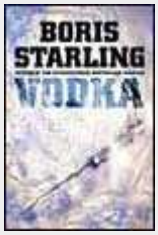
RUSSIA and Russians have been the subjects of some of the best novels ever written. But where is post-Communist Russia's Pasternak, its Dostoevsky or its Tolstoy? The great themes of the past emerge in new and exciting forms in the extraordinary changes of the past 20 years: the baffling loves and hates between foreigners and natives; war, peace and war again in Chechnya; the struggle to be honest in a crooked world; the illusions and disillusions of democracy and progress.

Yet no contemporary Russian novelist so far has approached these heights. Viktor Pelevin's intriguing “Generation P” (1999) is probably the best attempt so far: but it is incomplete and slipshod. So perhaps a foreigner? And why not through a thriller? After all, the world understands the atmosphere, dilemmas and neuroses of cold-war Germany more thanks to John le Carré than to modern German novels.

Vodka
By Boris Starling



HarperCollins; 503 pages; £12

Buy it at
Amazon.co.uk

This book, the third by Boris Starling, a British thriller writer, is big and ambitious. Its 500-or-so pages include at least a dozen themes that even singly would be more than enough for a serious novel. On one level the story is about business: the hasty and symbolic privatisation of a fictional Moscow vodka factory, Red October, in the months after the collapse of the Soviet Union. The way that factory bosses, reared in the looking-glass world of the planned economy, turned into ruthless market-minded owner-managers, and what their colleagues and workers thought of it all, is a great story just on its own.

In Red October's case, there is another dimension: the involvement of organised crime, which turns out to have been running the factory for years with the tacit consent of the authorities. The overlap between business, government and gangsterdom in Russia's move to capitalism is as gripping as it is murky.

The third big theme is the self-destructive love of the central character, an American banker called Alice Liddell, for Moscow's bewitching chaos and squalor. On assignment to Red October, she finds her previous experience in the calmer countries of central Europe little guide to the extremes of behaviour she encounters. That encourages her to develop the alcoholism which is the fourth theme of the book.

All this might seem enough to be going on with, but the author adds another element, the uneasy and intricate relationship between Russians and the formerly captive nations of the Baltic states. Mr Starling's only truly sympathetic character is an Estonian working (improbably) in Moscow as an incorruptible senior prosecutor.

For good measure, the subplots also include Moscow's fascinating sewers, the Chechen-Russian gangster wars, a vampire with a taste for children's blood, the traumas of veterans of the war in Afghanistan and three grisly torture scenes. Never a dull moment, in fact. Despite all its excitements, though, the book is flawed. The relationship with fact is uneasy. The author tries to be authentic, featuring real figures, places and events in the lightest of disguises (Red October exists, and was privatised, but it makes sweets not vodka). But being convincing demands more accuracy than Mr Starling can manage. Names are often deeply implausible (Russian women, especially destitute orphan girls, are not likely to be called Emma); there are anachronisms galore, and whereas the westerners are all too convincing, the Russian characters talk and behave far too like Americans to be properly plausible.

It is also a mistake to pack the book with every imaginable cliché and aphorism about the country's national character: Moscow is an overgrown village; Russia has a soul; it can't be understood with the mind, and so on. By the end the reader is unsure whether he has finished a particularly lurid textbook or

a very didactic novel.

Rather than explore one or two themes thoroughly, Mr Starling has let his fascination with Russia get the better of him. The result is like one of the gargantuan but indigestible banquets he describes so vividly: impressive but over-elaborate, with some dishes overcooked and others raw.

Vodka.
By Boris Starling.
HarperCollins; 503 pages; £12

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About sponsorship

New theatre

Touching a void

Mar 18th 2004
From The Economist print edition

Make sure you pick the right Beckett

Unhappiness—there's nothing funnier

WOULD you rather see a classic play *by* Samuel Beckett or a new one that is *about* him—specifically about that time early in his career when the Irish dramatist was in Paris befriending James Joyce? Most of you, presumably, would opt for the latter. After all, isn't it easier to read about great writers than to experience their more daunting works first hand?

London's West End theatre is currently hosting a scenario that intriguingly revises this hypothesis. Beckett's bleak masterwork, “Endgame”, has just opened in a rare commercial revival at the Albery theatre, minutes away from “Calico”, a Michael Hastings drama at the Duke of York's theatre that puts Beckett and Joyce centre-stage. How do the plays stack up?

For all its supposed daring in portraying the dysfunctionality of some pretty important people, “Calico” emerges as a ham-fisted attempt to ride piggyback on a few big literary names. Beckett's spare, short “Endgame”, on the other hand, doesn't have to advertise its audacity; that much simply exists in a play whose maverick tendencies leave Mr Hastings's pretensions looking especially puny. No wonder Daniel Weyman, who makes a singularly gaunt, spindly Beckett, spends much of “Calico” looking on, his face agog. You would, too, if you were a dramatic trailblazer who had inadvertently lent your cachet to so crude a play.

Mr Hastings has tilled similar dramatic soil before: two decades ago in “Tom and Viv”, a play about T.S. Eliot's early marriage to a mentally unsteady English socialite, Vivienne Haigh-Wood. (The play was subsequently made into a 1994 film that received Academy Award nominations for two of its performers.) Here, his focus is on the clearly damaged Lucia Joyce, the younger of the two children born to the author of “Finnegans Wake”. At the age of 21, Lucia suffers from multiple delusions that include a far-from-healthy fixation on Beckett, who—one year Ms Joyce's senior—also happens to be making his literary way around Paris in 1928, the year the play is set.

“Calico” is rife with authorial name-dropping (F. Scott Fitzgerald, for one, is dismissed as “just a Yank”) and of two bewildering minds about the men of letters at its core. All it apparently takes to characterise Beckett is to have the writer speak a line about “the empty silence of not knowing”—to sound, in other words, like a character out of one of his plays. Poor Joyce, played behind thick glasses by Dermot Crowley so as to indicate the novelist's dwindling eyesight, gets it even worse. One moment, his beloved Nora Barnacle (played by a shrill Imelda Staunton) is deriding “Ulysses” as the book “nobody can understand (or) read”. But lest such remarks in turn lose the audience, Nora also is heard to praise her husband as “the world's greatest novelist of books”. How reassuring.

And how gratifying to be able to seek refuge in Beckett's actual plays, few of which pose greater demands than the 1957 “Endgame”. This is the play, you may recall, dominated by the blind, immobile Hamm, who barks orders at his malformed, antic sidekick, Clov, even as Hamm's parents, Nagg and Nell, pop up now and again from two nearby dustbins. Too cramped for comfort? Perhaps, though that is to discount one of the play's crucial remarks—the dying Nell's admission that “nothing is funnier than unhappiness”. Accordingly, Matthew Warchus, the director, honours the quality of gamesmanship implicit in the very title “Endgame”, turning Sir Michael Gambon's Hamm and Lee Evans's Clov into vaudevilleans who, separately and together, must face down a considerable void.

The two men do so with gallantry and grace, a sly wit and very real wisdom. While “Calico” is best regarded, if at all, as an exercise in kitsch, “Endgame” renews a power that looks to be everlasting.

“Calico” is at the Duke of York’s theatre, London, until May 29th. “Endgame” is at the Albery theatre, London, until May 1st

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About sponsorship

Daniel Boorstin

Mar 18th 2004
From The Economist print edition

Getty

Daniel Boorstin, a great amateur, died on February 28th, aged 89

ON FEBRUARY 12th 1976, not long after his appointment as the 12th Librarian of Congress, Daniel Boorstin organised a press conference. In his more waspish moods he would have condemned it as a "pseudo-event", designed to fill newspapers and stimulate Beltway chatter. But this was something different. Mr Boorstin produced an ancient blue cardboard box with a dangling key and, in the presence of the press, unlocked it.

Inside were the contents of President Lincoln's pockets on the night he was assassinated. Two pairs of spectacles; a lens polisher; a pocket knife; the fob of a watch; a leather wallet; a linen handkerchief; and nine newspaper clippings admiring of the president's policies. Mr Boorstin had found the box, previously neglected, on a shelf in his office. Now these poignant everyday objects were laid out on a table for everyone to see.

The event was typical of him in several ways. Most obviously, on that day, it summed up his attitude to his new job: to throw open the great brass doors of the Library of Congress, to open unopened boxes, and to bring the world of books and learning to as wide a public as possible. Mankind, he often said, had never produced a technical feat to match the book. His aim was to put 20th-century Americans back in touch with literature and learning, and to unlock the possibilities of progress and creation latent in their minds.

His loving retrieval of Lincoln's spectacles and clippings also typified his attitude to history. He was an extraordinarily wide-ranging historian, producing more than 20 books that encompassed, between them, most of the cultural development of western civilisation. Yet he wrote his history not as sweeping cycles or grand themes, but in terms of individual discovery and experience. For him, the contents of Lincoln's pockets were almost as important as the Gettysburg address.

Mr Boorstin believed strongly in American exceptionalism, but in his own distinctive way. America was not better, more virtuous or more progressive than other countries. It was unique because it was founded on pragmatism rather than ideology, and was forged into a nation by the effort and necessity of taming a wild continent. This, he believed, made its institutions peculiarly flexible, and its leaders more willing to revise, rethink and recreate whenever circumstances required it. His favourite president was Thomas Jefferson, with his passion to make all things new.

His greatest hero, however, was Edward Gibbon, the 18th-century historian. As Mr Boorstin loved to point out, Gibbon was an amateur: a man who, without belonging to any professional association or bowing to historical conventions, produced the most impressive work of history of his age. Mr Boorstin hoped to do the same, priding himself that he had never done a doctorate in history and had no inkling of the rules he was meant to follow. His only qualification, he insisted, was that he loved it: *amo*, of course, being the root of “amateur”. As America's chief librarian he found himself an amateur again, and delighted just as much in the outraged snorts of the professionals.

The indefatigable typist

Mr Boorstin's early training, in fact, had been in law. In this he took after his father; and in other things, too. Boorstin senior had moved from Atlanta to Tulsa, Oklahoma, in 1916 partly to escape anti-Semitism, but partly because he wanted to help with the founding of a new community. When his father came to Tulsa, Mr Boorstin said, the skyscrapers did not yet exist; they had to be imagined. And, in the typical way of American genius, they were no sooner imagined than they began to rise out of the Oklahoma plains.

For young Daniel, Tulsa was followed by Harvard (at 15), a stint at Oxford, a double first in law, a calling to the British bar (a rare honour indeed for an American), and, from 1944, 25 years as a professor at the University of Chicago. Everywhere he wrote, indefatigably tapping away on his old Olympia manual early in the mornings and deep into the weekends. Writing was his life, and he could not possibly stop.

Worshipping, as he did, the original vigour of the American experiment, he often found modern America hard to take. In tweed jacket, glasses and bow tie, he played the closeted academic to perfection; but his perception of his own times was acute. His most influential book, “The Image”, published in 1962, was the first to describe the phenomena of non-news, spin, the cult of the image and the worship of celebrity. The vacuity and homogeneity of much of modern life appalled him. “The American citizen”, he wrote once,

> ...lives in a world where fantasy is more real than reality, where the image has more dignity than its original. We hardly dare face our bewilderment, because our ambiguous experience is so pleasantly iridescent, and the solace of belief in contrived reality is so thoroughly real. We have become eager accessories to the great hoaxes of the age. These are the hoaxes we play on ourselves.

Americans had not always been this way. As Mr Boorstin proved to the press that February morning in 1976, this was once a country where the president himself carried a pocket-knife, the better to cope boldly and practically with real life when it challenged him.

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Overview

Mar 18th 2004
From The Economist print edition

Stockmarkets tumbled across Europe following a bomb attack in Madrid that was later linked to Islamic terrorists. Over the five trading days following the attack, Spain's stockmarket fell by 4.0%, France's CAC-40 fell by 2.7% and Germany's DAX fell by 3.7%.

American industrial production rose by a stronger-than-expected 0.7% in February. In the year to February, industrial output rose by 2.7% and manufacturing output rose by 3.2%.

As expected, the Federal Reserve kept **interest rates** unchanged at 1.0%. In its statement, the Fed confirmed that “output is continuing to expand at a solid pace.” But it was less enthusiastic about jobs. It said: “Although job losses have slowed, new hiring has lagged.”

American **consumer prices** rose by 0.3% in February. Inflation in the year to February ran at 1.7%, down from 1.9% in the year to January.

Despite falling mortgage rates, America's **housing market** is slowing. Housing starts fell by 4% in February, following a 6% fall in January.

Euro-area industrial production grew by a meagre 0.6% in the year to January. Business confidence in **Germany** fell by more than expected in March. The ZEW index fell to 57.6 from 69.9 in February, due to worries that the Madrid terrorist attacks might undermine euro-area growth. **French** industrial output fell by a greater-than-expected 0.5% in January, thanks mostly to falling car production; industrial production for the year to January rose by 0.9%. Industrial output rose by 3.4% in the year to October in **Austria**, and by 1.2% in the year to January in **Belgium**.

Retail sales in **Switzerland** rose by 3.1% in the year to January.

Retail sales in **Canada** rose by 0.8% in the year to December.

Consumer prices in **Britain**, as measured by the Consumer Price Index (CPI), rose by 0.3% in February, matching analysts' expectations. For the year to February, inflation fell slightly to 1.3%, down from 1.4% in the year to January. Prices for clothing and footwear rebounded more slowly than usual from winter sales.

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Output, demand and jobs

Mar 18th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.7	+ 3.3	– 0.1	Q3	+ 7.3	Q4	5.9	Feb	6.1
Austria	+ 0.8	Q3	+ 1.4	+ 1.8	+ 2.1	+ 3.4	Oct	+ 0.1	Dec	4.4	Feb	4.2
Belgium	+ 1.2	Q4	+ 2.4	+ 1.8	+ 2.1	+ 1.2	Jan	– 0.7	Dec	12.8	Feb†	11.8
Britain	+ 2.8	Q4	+ 3.8	+ 3.0	+ 2.5	+ 0.4	Jan	+ 6.4	Jan	4.8	Jan††	5.0
Canada	+ 1.6	Q4	+ 3.8	+ 3.0	+ 3.2	+ 1.5	Dec	+ 0.8	Dec	7.4	Feb	7.5
Denmark	+ 0.3	Q4	+ 1.2	+ 2.0	+ 2.3	– 1.5	Jan	+ 1.8	Dec	6.5	Jan	5.5
France	+ 0.6	Q4	+ 1.8	+ 1.9	+ 2.2	+ 0.9	Jan	– 2.2	May	9.6	Jan	9.3
Germany	+ 0.2	Q4	+ 0.9	+ 1.6	+ 1.8	+ 1.4	Jan	– 2.9	Jan	10.3	Feb§	10.5
Italy	+ 0.1	Q4	nil	+ 1.6	+ 2.0	+ 0.3	Jan	– 1.5	Dec	8.4	Oct	8.9
Japan	+ 3.4	Q4	+ 6.4	+ 2.6	+ 1.8	+ 4.9	Jan	+ 1.5	Jan	5.0	Jan	5.5
Netherlands	– 0.5	Q4	+ 1.2	+ 1.0	+ 1.9	+ 0.7	Jan	– 6.3	Dec‡	6.1	Jan**	4.1
Spain	+ 2.7	Q4	+ 3.0	+ 2.9	+ 2.9	+ 2.9	Jan	+ 4.5	Jan	11.2	Jan	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.5	+ 2.6	+ 5.2	Jan	+ 3.7	Jan	6.0	Feb†	4.5
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.9	+ 0.4	Q3	+ 3.1	Jan	4.2	Feb†	3.6
United States	+ 4.3	Q4	+ 4.1	+ 4.7	+ 3.5	+ 2.7	Feb	+ 6.0	Jan	5.6	Feb	5.9
Euro area	+ 0.6	Q4	+ 1.2	+ 1.8	+ 2.2	+ 0.6	Jan	+ 1.0	Jan	8.8	Jan	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	– 1.1	Jan	+ 7.3	Jan	9.5	Jan†	9.5
Greece	+ 5.0	Q4	na	na	na	+ 1.6	Dec	+ 6.4	Nov	na		na
Iceland	+ 3.2	Q3	na	na	na	– 0.3	2002	na		3.4	Dec†	3.0
Ireland	– 0.1	Q3	na	na	na	+ 8.9	Jan	+ 0.3	Jan	4.7	Feb	4.3
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 5.8	Oct	4.5	Jan	3.8
New Zealand	+ 3.5	Q3	+ 6.3	na	na	+ 4.1	Q3	+ 6.0	Q4	4.6	Q4	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 0.5	Jan	+ 4.4	Jan	4.2	Q4	3.7
Portugal	– 0.5	Q4	– 1.0	na	na	– 3.0	Jan	+ 1.1	Jan	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Nov-Jan; claimant count rate 2.9% in Feb. §EU harmonised rate 9.3% in Feb. **Nov-Jan. +

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Prices and wages

Mar 18th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.4	Q4	+ 3.0	+ 2.2	+ 2.6	– 1.1	Q4	+ 1.6	+ 5.9	Q4	+ 3.9
Austria	+ 1.4	Feb	+ 1.7	+ 1.1	+ 1.4	+ 1.8	Feb	+ 2.1	+ 2.2	Jan	+ 2.2
Belgium	+ 1.3	Feb	+ 1.7	+ 1.4	+ 1.6	+ 2.1	Jan	+ 0.1	+ 1.8	Q4	+ 2.2
Britain	+ 1.3	Feb*	+ 1.6	+ 1.5	+ 1.8	+ 1.6	Feb	+ 1.5	+ 4.4	Jan	+ 3.7
Canada	+ 1.2	Jan	+ 4.5	+ 1.5	+ 2.0	– 3.6	Jan	+ 2.4	+ 5.5	Dec	+ 1.6
Denmark	+ 0.9	Feb	+ 2.9	+ 1.5	+ 2.0	– 0.1	Feb	+ 1.7	+ 3.7	Q4	+ 3.9
France	+ 1.8	Feb	+ 2.6	+ 1.8	+ 1.6	+ 0.2	Jan	+ 1.7	+ 2.7	Q4	+ 3.5
Germany	+ 0.9	Feb	+ 1.3	+ 1.0	+ 1.1	+ 0.1	Feb	+ 1.6	+ 1.9	Jan	+ 2.5
Italy	+ 2.3	Feb	+ 2.6	+ 2.3	+ 2.1	+ 0.3	Jan	+ 2.5	+ 2.7	Dec	+ 2.2
Japan	– 0.3	Jan	– 0.4	– 0.2	nil	nil	Feb	– 0.8	+ 1.5	Jan	+ 1.1
Netherlands	+ 1.2	Feb	+ 2.4	+ 1.5	+ 1.4	+ 0.6	Dec	+ 4.2	+ 2.0	Feb	+ 3.3
Spain	+ 2.1	Feb	+ 3.7	+ 2.5	+ 2.5	+ 0.7	Jan	+ 2.6	+ 3.1	Q3	+ 3.8
Sweden	+ 0.8	Jan	+ 2.8	+ 1.4	+ 1.9	– 2.1	Jan	– 0.2	+ 2.7	Dec	+ 4.0
Switzerland	+ 0.1	Feb	+ 1.0	+ 0.5	+ 0.9	– 0.2	Jan	– 0.2	+ 1.8	2002	+ 2.5
United States	+ 1.7	Feb	+ 3.0	+ 1.5	+ 1.8	+ 4.0	Dec	+ 1.2	+ 1.6	Feb	+ 3.4
Euro area	+ 1.6	Feb	+ 2.4	+ 1.7	+ 1.6	+ 0.3	Jan	+ 2.3	+ 2.6	Q3	+ 3.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.1	Feb	+ 1.9	na	na	– 1.8	Feb	+ 2.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.5	Feb	+ 4.3	na	na	+ 2.3	Jan	+ 0.5	na		na
Iceland	+ 1.8	Mar	+ 2.2	na	na	+ 1.4	Feb	+ 3.5	+ 3.3	Jan	+ 5.5
Ireland	+ 1.7	Feb	+ 5.1	na	na	– 8.2	Jan	– 5.3	+ 4.7	Q3	+ 6.0
Luxembourg	+ 2.0	Feb	+ 2.5	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.6	Q4	+ 2.7	na	na	– 0.1	Q4	– 1.4	+ 2.3	Q4	+ 2.1
Norway	– 1.7	Feb	+ 4.8	na	na	– 1.3	Feb	+11.9	+ 3.9	Q4	+ 5.2
Portugal	+ 2.1	Feb	+ 4.2	na	na	– 0.3	Jan	+ 2.6	– 2.6	Dec	+ 0.4

*New series. RPI inflation rate in February: 2.5%. †RPI.

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Government spending

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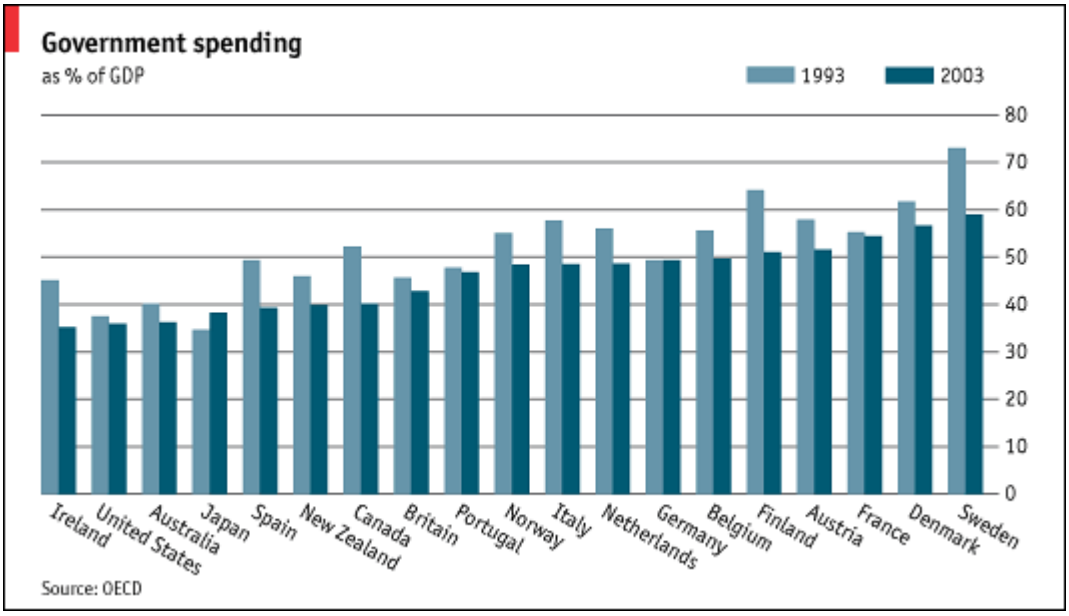
From The Economist print edition



Public expenditure as a proportion of GDP has fallen in most rich countries over the past decade, especially in countries with the most generous welfare states. Between 1993 and 2003, government spending fell from 73% to 59% of GDP in Sweden and from 64% to 51% of GDP in Finland. Germany and Japan were the only two countries in our chart which have seen a rise in government spending as a fraction of output.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Mar 17th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 9.1	+13.8	Jan	5.48	4.75	4.96	5.29	5.46	6.24
Britain	+ 7.6	+ 8.3	Jan	4.22	3.59	4.25	4.66	4.50	5.56
Canada	+ 7.0	+ 7.7	Jan	2.02	3.06	2.24	4.16	5.16	5.81
Denmark	+ 6.4	+ 6.7	Jan	2.13	2.75	2.26	4.00	4.41	5.19
Japan	+ 4.3	+ 1.7	Feb	0.03	0.02	0.10	1.30	0.71	1.32
Sweden	+ 3.3	+ 2.2	Jan	2.45	3.37	2.72	4.20	4.70	2.80
Switzerland	+24.0	+ 7.8	Feb	0.25	0.32	0.67‡	2.29	2.53	2.18
United States	+ 6.4	+ 3.9	Feb	0.99	1.21	1.48	3.68	3.96	5.41
Euro area†	+11.2	+ 6.4	Jan	2.05	2.56	2.13	3.84	4.17	3.69

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. New Series. Benchmarks: US 30-year 4.68%, Japan No. 258 1.31%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.0%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Mar 18th 2004
From The Economist print edition

1995=100

	Mar 9th	Mar 16th*	% change on one month	% change on one year
Dollar index				
All items	96.0	98.0	+ 3.1	+28.0
Food	93.7	96.7	+ 7.0	+24.9
Industrials				
All	99.1	99.7	– 1.7	+32.2
Nfa†	96.9	94.4	– 1.4	+19.3
Metals	100.9	104.2	– 1.9	+44.2
Sterling index				
All items	82.4	85.0	+ 7.8	+10.1
Euro index				
All items	101.7	104.4	+ 7.1	+10.2
Yen index				
All items	113.5	113.6	+ 6.1	+17.3
Gold				
$ per oz	401.75	403.10	– 2.5	+18.8
West Texas Intermediate				
$ per barrel	36.27	37.43	+ 6.4	+18.9

* Provisional. † Non-food agriculturals.

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Stockmarkets

Mar 18th 2004
From The Economist print edition

Market indices

	Mar 17th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,432.3	3,432.3	3,274.9	+ 0.5	– 0.2	+ 3.8	+ 1.6
Austria (ATX)	1,821.8	1,863.1	1,568.9	– 1.2	– 2.2	+17.9	+14.0
Belgium (Bel 20)	2,403.6	2,517.3	2,244.2	– 3.0	–34.7	+ 7.1	+ 3.5
Britain (FTSE 100)	4,456.8	4,559.1	4,377.7	– 1.9	–35.7	– 0.4	+ 0.7
Canada (Toronto Composite)	8,601.7	8,874.7	8,220.9	+ 0.2	–24.5	+ 4.6	+ 0.7
Denmark (KBX)	234.6	241.3	219.0	– 1.6	–22.3	+ 9.8	+ 6.2
France (SBF 250)	2,502.9	2,594.4	2,411.5	– 2.7	–43.0	+ 3.8	+ 0.3
(CAC 40)	3,656.0	3,785.4	3,557.9	– 2.7	–47.2	+ 2.8	– 0.7
Germany (DAX)	3,896.8	4,151.8	3,810.8	– 3.7	–51.7	– 1.7	– 5.0
Italy (BCI)	1,267.5	1,325.5	1,258.7	– 3.9	–41.9	+ 0.9	– 2.5
Japan (Nikkei 225)	11,436.9	11,537.3	10,365.4	nil	–70.6	+ 7.1	+ 6.0
(Topix)	1,141.7	1,141.7	1,022.6	+ 1.2	–60.4	+ 9.4	+ 8.3
Netherlands (AEX)	345.1	364.8	337.2	– 2.7	–50.8	+ 2.2	– 1.2
Spain (Madrid SE)	833.3	875.0	808.3	– 4.0	–27.3	+ 3.1	– 0.3
Sweden (Affarsvarlden Gen)	204.2	218.1	188.5	– 1.7	–49.0	+ 8.4	+ 2.9
Switzerland (Swiss Market)	5,692.2	5,934.4	5,507.7	– 3.1	–32.3	+ 3.7	– 0.1
United States (DJIA)	10,300.3	10,737.7	10,102.9	nil	–12.1	– 1.5	– 1.5
(S&P 500)	1,123.8	1,157.8	1,104.5	nil	–26.4	+ 1.1	+ 1.1
(NASDAQ Comp)	1,976.8	2,153.8	1,939.2	+ 0.6	–60.8	– 1.3	– 1.3
Europe (FTSE Eurotop 300)*	989.7	1,026.2	957.9	– 2.3	–42.0	+ 3.3	– 0.1
Euro area (FTSE Ebloc 100)*	848.5	888.3	829.9	– 3.3	–45.3	+ 2.0	– 1.4
World (MSCI)†	1,049.6	1,085.8	1,030.1	– 0.5	–27.6	+ 1.3	+ 1.3
World bond market (Citigroup)‡	606.7	619.5	595.1	+ 0.9	– 2.1	+ 0.5	+ 0.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Mar 18th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2004	Current account The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Mar 17th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Mar 17th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 15.9 Jan	− 30.0 Q4	− 5.1	− 4.5	87.0	76.7	1.36	1.69	2.46	1.65	1.25	0.5
Austria	− 1.2 Dec	− 1.2 Dec	− 0.2	− 0.3	103.4§	101.6	0.82	0.94	1.48	–	0.76	-1.2
Belgium	+ 19.3 Jan	+ 9.9 Sep	+ 4.1	+ 4.2	103.8§	101.4	0.82	0.94	1.48	–	0.76	nil
Britain	− 79.8 Jan	− 36.1 Q3	− 2.4	− 2.3	104.6	100.9	0.55	0.64	–	0.67	0.51	-2.9
Canada	+ 43.5 Jan	+ 18.5 Q4	+ 1.4	+ 1.0	85.9	79.5	1.34	1.48	2.43	1.64	1.24	0.7
Denmark	+ 9.6 Jan	+ 6.5 Jan	+ 2.6	+ 2.6	106.5	105.0	6.11	7.01	11.1	7.45	5.64	1.0
France	+ 2.5 Jan	+ 16.7 Jan	+ 1.2	+ 1.2	107.4§	104.5	0.82	0.94	1.48	–	0.76	-3.7
Germany	+152.8 Jan	+ 57.1 Jan	+ 2.5	+ 2.4	105.2§	101.7	0.82	0.94	1.48	–	0.76	-3.7
Italy	+ 2.1 Dec	− 20.6 Dec	− 1.0	− 0.8	76.6§	74.5	0.82	0.94	1.48	–	0.76	-2.9
Japan	+110.2 Jan	+142.3 Jan	+ 3.0	+ 2.9	136.1	131.4	108	120	196	132	–	-6.8
Netherlands	+ 31.9 Jan	+ 14.4 Q4	+ 3.2	+ 3.4	103.4§	100.6	0.82	0.94	1.48	–	0.76	-2.5
Spain	− 52.5 Dec	− 26.7 Dec	− 2.5	− 2.6	77.7§	75.9	0.82	0.94	1.48	–	0.76	0.2
Sweden	+ 19.2 Jan	+ 18.9 Q4	+ 4.8	+ 4.5	80.3	78.9	7.58	8.68	13.7	9.25	7.00	0.5
Switzerland	+ 7.3 Feb	+ 29.4 Q3	+10.6	+10.6	110.7	115.9	1.28	1.39	2.33	1.57	1.19	na
United States	−552.7 Jan	−540.9 Q4	− 5.1	− 4.9	96.9	108.9	–	–	1.81	1.22	0.92	-5.1
Euro area	+ 83.5 Dec	+ 36.5 Dec	+ 0.7	+ 0.6	90.6	86.1	0.82	0.94	1.48	–	0.76	-2.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.4 Jan	+ 9.6 Jan	na	na	82.7§	80.3	0.82	0.94	1.48	–	0.76	1.9
Greece	− 25.7 Dec	− 11.3 Dec	na	na	59.9§	58.7	0.82	0.94	1.48	–	0.76	-1.6
Iceland	− 0.3 Jan	− 0.4 Q3	na	na	93.5**	92.9	70.4	79.9	127	85.8	65.0	0.2
Ireland	+ 39.2 Dec	− 2.1 Q3	na	na	95.8§	91.6	0.82	0.94	1.48	–	0.76	-1.3
Luxembourg	− 3.4 Dec	+ 2.0 Q3	na	na	103.8§	101.4	0.82	0.94	1.48	–	0.76	-1.8
New Zealand	− 2.2 Jan	− 3.3 Q3	na	na	102.4	97.4	1.55	1.81	2.81	1.89	1.43	2.2
Norway	+ 27.8 Feb	+ 28.8 Dec	na	na	95.2	100.4	6.94	7.44	12.6	8.46	6.41	9.7
Portugal	− 13.5 Nov	− 8.2 Nov	na	na	93.4**	91.3	0.82	0.94	1.48	–	0.76	-3.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, January average. ‡OECD estimate.
**IMF, November average.

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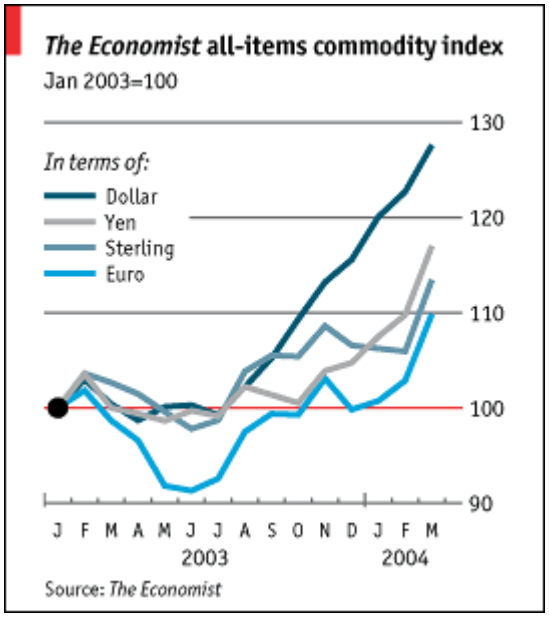
The Economist all-items commodity index

Mar 18th 2004
From The Economist print edition

Our dollar-based commodity index has risen by 28% since the beginning of 2003. Thanks to a stronger euro, however, our index has risen by only 10% when quoted in that currency.



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Overview

Mar 18th 2004
From The Economist print edition

Indian industrial production rose in the year to January by 7.4%.

Peru's economy grew by 3.0%, also in the year to January.

Consumer-price inflation in **Poland** ran at 1.6% in the year to February, unchanged from the year to January. Analysts had expected inflation to rise to 1.8%.

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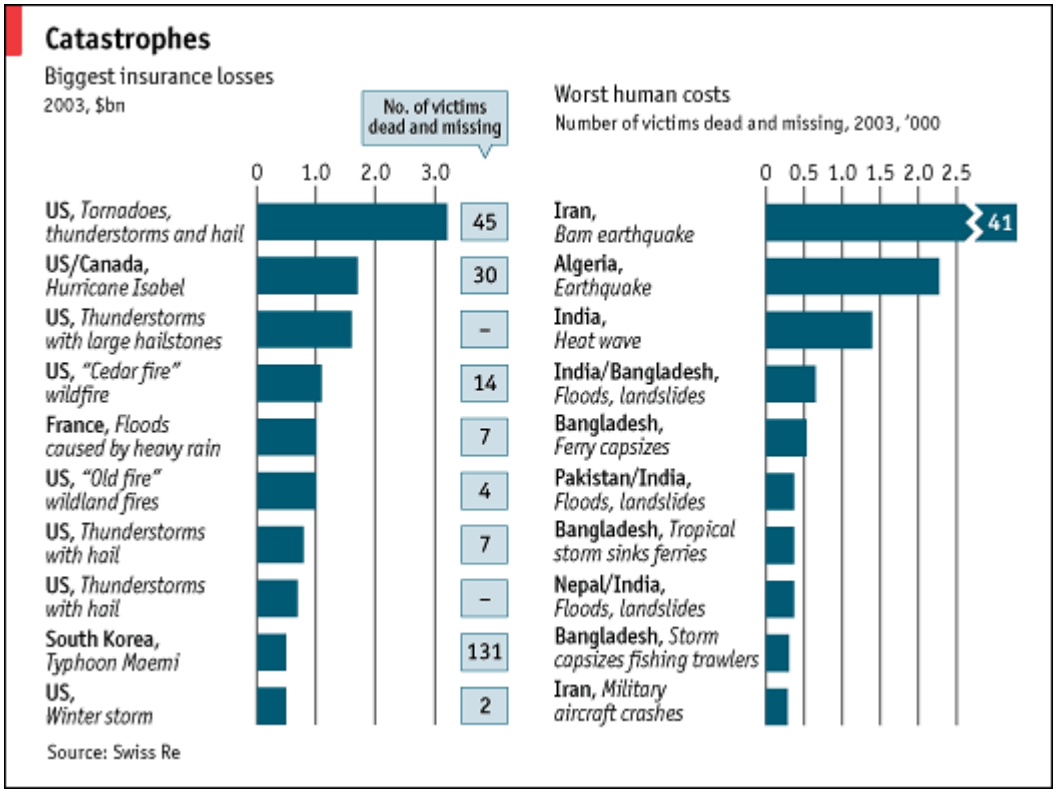
Catastrophes

Mar 18th 2004
From The Economist print edition



According to Swiss Re, an insurance company, 60,000 people died in 380 man-made and natural catastrophes last year. Earthquakes were responsible for almost three-quarters of the victims. The biggest single human toll was seen in Iran, where 41,000 people died in an earthquake in the city of Bam. Severe storms in America caused the biggest insurance payouts, around $3 billion.

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Economy

Mar 18th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+23.2	Feb	+ 2.1	Feb	+18.1	Feb	+35.4	2002	403.3	Dec
Hong Kong	+ 4.0	Q3	– 9.2	Q3	– 1.5	Jan	– 8.3	Jan	+17.0	Q3	123.5	Feb
India	+ 8.4	Q3	+ 7.4	Jan	+ 4.3	Jan	–15.6	Jan	+ 2.3	Q3	104.1	Feb
Indonesia	+ 4.3	Q4	+ 4.7	Jul	+ 4.6	Feb	+28.5	Jan	+ 7.8	Q3	34.7	Jan
Malaysia	+ 6.4	Q4	+16.7	Jan	+ 0.9	Feb	+19.5	Jan	+11.9	Q3	43.5	Jan
Philippines	+ 4.5	Q4	– 3.1	Dec	+ 3.4	Feb	– 1.8	Dec	+ 3.1	Oct	12.7	Feb
Singapore	+ 4.9	Q4	+ 5.8	Jan	+ 1.3	Jan	+15.1	Jan	+28.2	Q4	101.2	Feb
South Korea	+ 2.3	Q3	+ 4.8	Jan	+ 3.3	Feb	+21.1	Feb	+15.2	Jan	162.1	Feb
Taiwan	+ 5.2	Q4	– 1.1	Jan	+ 0.6	Feb	+16.3	Feb	+28.6	Q4	224.8	Feb
Thailand	+ 7.8	Q4	+11.6	Jan	+ 2.2	Feb	+ 4.2	Jan	+ 8.1	Jan	42.2	Jan
Argentina	+ 9.8	Q3	+ 8.8	Jan	+ 2.3	Feb	+14.8	Jan	+ 8.9	Q3	14.7	Jan
Brazil	– 0.1	Q4	+ 1.7	Jan	+ 6.7	Feb	+26.1	Feb	+ 4.6	Jan	53.3	Jan
Chile	+ 3.0	Q3	+ 1.8	Jan	+ 0.8	Jan	+ 3.5	Feb	– 0.6	Q4	16.0	Jan
Colombia	+ 4.3	Q4	+ 3.6	Dec	+ 6.3	Feb	nil	Nov	– 1.6	Q3	11.1	Jan
Mexico	+ 2.0	Q4	+ 0.8	Jan	+ 4.2	Jan	– 5.6	Jan	– 9.2	Q4	59.2	Feb
Peru	+ 3.0	Jan	– 1.9	Dec	+ 3.4	Feb	+ 0.9	Jan	– 1.1	Q4	9.8	Jan
Venezuela	+ 9.0	Q4	– 4.8	Oct	+21.9	Feb	+15.0	Q4	+ 9.6	Q4	16.0	Dec
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Jul	+ 3.3	Q3	14.1	Dec
Israel	– 0.6	Q4	+ 1.3	Dec	– 2.5	Feb	– 6.5	Feb	– 0.2	Q4	26.2	Feb
South Africa	+ 1.5	Q4	– 1.4	Dec	+ 0.2	Jan	+ 1.9	Jan	– 1.3	Q3	6.4	Jan
Turkey	+ 4.8	Q3	+ 6.5	Jan	+14.3	Feb	–21.9	Dec	– 5.5	Nov	33.6	Dec
Czech Republic	+ 3.1	Q4	+ 3.8	Jan	+ 2.3	Feb	– 2.5	Jan	– 5.7	Q4	26.8	Feb
Hungary	+ 3.5	Q4	+ 9.9	Jan	+ 7.1	Feb	– 3.8	Jan	– 5.2	Jan	13.1	Feb
Poland	+ 3.9	Q3	+14.3	Jan	+ 1.6	Feb	– 9.7	Dec	– 3.2	Dec	35.4	Jan
Russia	+ 5.7	Q3	+ 8.7	Feb	+10.8	Feb	+60.7	Jan	+39.1	Q4	80.2	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.8	Q4	+ 7.6	Jan	+ 0.4	Feb	– 2.0	Jan	– 1.6	Q4	1.2	Jan
Latvia	+ 7.4	Q4	+ 6.9	Dec	+ 4.3	Feb	– 2.0	Dec	– 0.9	Dec	1.4	Jan
Lithuania	+10.6	Q4	na		– 1.3	Feb	– 2.7	Jan	– 1.1	Q3	3.3	Jan
Slovakia	+ 4.2	Q3	+ 1.3	Jan	+ 8.5	Feb	– 0.6	Jan	– 0.5	Nov	11.8	Jan
Slovenia	+ 2.3	Q3	+ 3.6	Dec	+ 3.6	Feb	– 0.8	Jan‡	nil	Dec	8.5	Dec
Pakistan	+ 5.1	2003†	+20.8	Oct	+ 5.2	Jan	– 1.5	Feb	+ 3.6	Q4†	11.0	Dec
Saudi Arabia	+ 1.0	2002	na		+ 0.4	Nov	+41.8	2002	+11.9	2002	22.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Mar 18th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 17th		Dec 31st 2003	
	Mar 17th	year ago	Mar 17th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.0	na	1,829.8	+4.0	+ 16.6	+ 16.6
Hong Kong	7.79	7.80	14.1	0.16	12,975.7	– 1.8	+ 3.2	+ 2.8
India	45.2	47.7	81.9	4.41	5,535.7	– 3.9	– 5.2	– 4.3
Indonesia	8,563	9,088	15,506	7.71	730.6	– 3.9	+ 5.6	+ 3.9
Malaysia	3.80	3.80	6.88	3.03	890.1	+1.6	+ 12.1	+ 12.1
Philippines	56.3	55.0	102.0	8.88	1,431.6	– 1.7	– 0.7	– 2.1
Singapore	1.70	1.77	3.08	0.69	1,833.6	– 2.2	+ 3.9	+ 3.9
South Korea	1,167	1,251	2,112	3.94	872.4	– 0.4	+ 7.6	+ 9.9
Taiwan	33.2	34.7	60.1	1.05	6,578.0	– 4.3	+ 11.7	+ 14.2
Thailand	39.5	43.0	71.5	1.31	674.4	– 4.4	– 12.7	– 12.4
Argentina	2.89	3.02	5.24	3.00	1,254.5	+1.2	+ 17.0	+ 18.7
Brazil	2.91	3.46	5.27	16.27	21,901.0	+0.6	– 1.5	– 2.3
Chile	610	737	1,104	1.68	7,587.9	– 1.4	+ 3.4	+ 0.5
Colombia	2,656	2,956	4,809	8.02	3,110.5	+0.7	+ 33.3	+ 39.5
Mexico	11.0	10.9	19.9	6.59	9,959.4	– 0.2	+ 13.2	+ 15.9
Peru	3.47	3.49	6.28	2.48	2,896.4	+4.1	+ 18.9	+ 18.9
Venezuela	3,449§	1,598	6,246	na	27,724.1	+0.1	+ 24.9	+ 3.2
Egypt	6.19	5.71	11.21	7.73	13,400.3	– 0.8	+ 15.1	+ 14.7
Israel	4.49	4.76	8.13	1.15	582.1	+1.4	+ 8.9	+ 6.7
South Africa	6.78	8.10	12.3	8.15	10,761.0	– 1.2	+ 3.6	+ 2.1
Turkey	1,323,500	1,718,500	2,396,594	20.00	19,294.5	– 2.5	+ 3.6	+ 10.0
Czech Republic	27.2	29.8	49.2	2.05	796.2	– 0.7	+ 20.8	+ 14.1
Hungary	210	232	380	12.26	10,637.8	– 0.6	+ 13.4	+ 12.2
Poland	3.87	4.08	7.00	5.48	23,668.7	– 1.0	+ 13.7	+ 10.0
Russia	28.5	31.4	51.7	14.00	698.7‡	+2.6	+ 20.2	+ 23.2
EMF (MSCI)*	1.00	1.00	1.81	na	470.0	– 1.3	+ 6.2	+ 6.2
EMBI+†	1.00	1.00	1.81	na	303.9	+0.3	+ 3.1	+ 3.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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